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CANGENE CORPORATION

ENDURING STRENGTHS

2005 Annual Report

ENDURING LEGACY

DR. JOHN (JACK) BOWMAN 1925–2005 | The success of Dr. Bowman's contribution to medicine is so complete, its efficacy so dramatic, that perhaps its most salient aspect is that the general public has forgotten its need.

Dr. Bowman was intensely dedicated to his practice. His work with pregnancies susceptible to hemolytic disease of the newborn saved thousands of new lives. Working with Dr. Bruce Chown at the Winnipeg General Hospital, Dr. Bowman treated at-risk expectant mothers with multiple blood transfusions, without which their babies would have died. This led to his development of WinRho®—the hyperimmune antibody product that prevents hemolytic disease of the newborn—which is now routinely used in Canada for at-risk pregnancies.

He graduated from the University of Manitoba in 1949 with the University Gold Medal in Medicine and the Manitoba Medical Association Gold Medal for Highest Overall Standing in Medicine. Along with many other awards, he was an Officer of the Order of Canada and recipient of the F.N.G. Starr Award, the highest award bestowed by the Canadian Medical Association. Dr. Bowman retired from practice in 1996, but continued to share his knowledge and passion with students for the rest of his life.

Dr. Bowman was Cangene's first medical director; he developed WinRho®, Cangene's flagship product, and he was responsible for many of the fundamental technologies used in the biotechnology industry. While his contributions are timeless, Dr. Bowman will be missed by all those whose lives he touched.

COMPANY PROFILE | Cangene is one of Canada's earliest biopharmaceutical companies. Its fully integrated operations include in-house drug-development and manufacturing expertise that allow it to produce its own drugs as well as those for other companies under contract.

Cangene boasts one of the broadest pipelines in the industry and a solid record of profitable product sales. Twin revenue streams from biopharmaceutical sales and contract R&D and manufacturing operations allow the Company to focus on developing its own pipeline of biodefence and infectious-disease-related products.

The Company has three approved products, three that are in late-stage development (including two that have been submitted for regulatory review) and several more at various stages of research and development.

Cangene develops and manufactures high-quality hyperimmune products—antibody products that may aid in the fight against challenging infectious diseases such as smallpox, Ebola, anthrax, West Nile and hepatitis B. Using experience garnered from producing its life-saving drug WinRho® SDF, Cangene specializes in manufacturing injectable products, and offers contract R&D and manufacturing services to other biopharmaceutical companies. Cangene is also developing products it intends to market as follow-on biologics.

Founded in 1984, Cangene has been listed on the Toronto Stock Exchange since 1991 under the symbol CNJ. The Company has operations in Manitoba and Ontario in Canada, and Maryland, Florida and California in the United States. The majority of its approximately 600 employees work in Winnipeg or at Chesapeake Biological Laboratories, Inc., Cangene's subsidiary in Baltimore. Additional company information can be found at www.cangene.com and www.cbilinc.com.

"Cangene", "WinRho", "WinRho SDF", "Leucotropin" and "VariZIG" are trademarks belonging to Cangene Corporation. The term "WinRho" may be used in this document to refer to any of the WinRho family of products.

Unless stated otherwise, dollar amounts are in Canadian dollars.

This annual report contains certain forward-looking statements that are subject to risks and uncertainties that may cause actual results or events to differ materially from the results or events predicted. These risks and uncertainties include, but are not limited to, those discussed in the RISKS AND UNCERTAINTIES section of the MD&A that begins on page 16 of this report. Forward-looking statements can be identified by the use of words such as "expects", "plans", "will", "believes", "estimates", "intends", "may", "bodes" and other words of similar meaning. Should known or unknown risks or uncertainties materialize, or should management's assumptions prove inaccurate, actual results could vary materially from those anticipated.

RECENT EVENTS AT A GLANCE

- Submitted Vaccinia immune globulin ("VIG") to FDA for review; given fast-track designation
- Began patient enrolment to test WinRho® SDF in dengue hemorrhagic fever
- Announced new anthrax hyperimmune project—collaboration with U.S. Department of Defense
- Appointed new CFO, Michael Graham, CA
- Identified as only potential supplier for anti-botulism toxin contract by the U.S. Centers for Disease Control and Prevention
- WinRho® SDF approved in additional ten European countries through the Mutual Recognition Procedure
- Analysis of interim data indicates WinRho® SDF met primary endpoint in dengue hemorrhagic fever trial
- Awarded a \$3.2-million VIG contract by Canadian government
- Recorded net loss in Q2 and Q4—only second time losses have been recorded in ten years; Q4 loss due to an \$18.0-million impairment loss relating to the Chesapeake viral vaccine facility
- Baxter assumed marketing and distribution rights for WinRho® SDF in the U.S.; aligning U.S. marketing with European
- FDA approved liquid formulation of WinRho® SDF
- FDA approved VIG only nine months after submission; Cangene's first FDA-licensed biodefence product and second FDA approval during the 2005 fiscal year
- New, independent board member, John Vivash, joined board of directors
- Awarded a \$17.0-million VIG contract by U.K. government
- Awarded supply contract for anthrax immune globulin for preliminary efficacy testing by U.S. Department of Health and Human Services

SELECTED FINANCIAL DATA

Years ended July 31

*in thousands of Canadian dollars
except per-share data*

	2005	2004	2003	2002	2001
Revenues	\$ 102,725	\$ 156,903	\$ 186,213	\$ 88,314	\$ 68,144
R&D expenses (net of investment tax credits)	34,212	25,611	18,070	13,157	11,620
Income taxes	5,606	18,703	22,066	10,214	8,598
Net income (loss) for the year	(15,463) ¹	32,542	40,090	10,434 ²	12,899
Basic earnings (loss) per share	(0.24) ¹	0.52	0.67	0.18 ²	0.22
Cash, end of year	3,985	3,999	6,273	1,473	8,936
Debt	27,264	8,902	36,715	73,942	66,133
Total shareholders' equity	149,690	160,132	119,397	78,673	67,340
Weighted-average number of common shares outstanding during the year	# 64,563,797	# 63,016,496	# 60,186,293	# 59,580,372	# 59,139,034

1 Reflects an \$18.0-million (\$0.28 per share) non-cash impairment loss related to the Chesapeake facility.

2 Reflects an expense of \$5.0 million (\$0.08 per share) related to a charge against goodwill.

ENDURING STRENGTHS

MESSAGE TO SHAREHOLDERS | *By Cangene's standards, this year's financial results were disappointing. Yet, this was also a year that produced two FDA product approvals, licensure of WinRho® SDF in ten European countries, and positive clinical trial results. These are solid accomplishments by anyone's standards, and demonstrate that Cangene comprises the enduring strengths—the committed people, the manufacturing expertise, the proprietary technologies—to sustain it, year after year.*

Two FDA approvals in one year—that's a huge achievement, particularly for a Canadian company. The first approval was for our liquid formulation of WinRho® SDF, which allows physicians to administer the product directly from the vial without reconstituting it first, as is necessary with the freeze-dried product. Ease of administration can be a key feature for a drug, and we are pleased to be able to offer this alternative to healthcare providers. Coincidentally, this approval followed less than two weeks after our new distribution partner, Baxter Healthcare Corporation, came on board in the United States. Both events are central to our strategy for the important U.S. market. Baxter is also our European distributor and we feel that coordinating our European and American marketing efforts through a single partner will strengthen the brand's presence in the marketplace.

The second approval was for our first biodefence product, Vaccinia immune globulin ("VIG"), and its approval came only nine months after we made the submission. VIG is a product for treating certain adverse reactions that can result from a smallpox vaccination, and as world governments plan vaccination or vaccine stockpiling programs, getting a supply of VIG could be integral to their plans. The U.S. government had already purchased a supply of VIG under the contract that drove our exceptional revenue in 2003, and this FDA approval lends further credibility to our product around the world. The Canadian government awarded us a contract in March and we just received an approximately \$17-million contract from the U.K. government. The U.S. Department of Defense has announced its intention to purchase a supply of VIG from us as well.

The other significant step for WinRho® SDF during the fiscal year was its approval in Belgium, Finland, Greece, Iceland, Ireland, Italy, Luxembourg, Norway, Portugal and the Netherlands through the European Mutual Recognition Procedure based on an earlier approval in the United Kingdom. Baxter will market the product, focusing mainly on the newer immune thrombocytopenic purpura ("ITP") indication, which has been largely untapped in these markets.

Rounding out the year for WinRho® SDF, our analysis of interim results from a clinical trial to evaluate its use treating dengue hemorrhagic fever ("DHF") showed positive results. Ninety percent of patients

Message to Shareholders

in the WinRho® SDF treatment group responded. DHF arises in severe cases of dengue fever, a mosquito-borne disease of the tropics, and causes increased blood vessel permeability resulting in plasma loss, decreased levels of blood platelets and hemorrhagic tendencies. The disease can ultimately kill through circulatory failure and shock. The trial results suggest that WinRho® SDF may be an effective treatment for this and other infectious diseases that may have dangerously low platelet counts associated with them. We plan to use the DHF results to assess this potential.

Biodefence and infectious disease applications have become the heart of our hyperimmune development program over the past several years. Each year, new potential targets for hyperimmune therapies are identified, providing Cangene with new opportunities. I already mentioned VIG, the first product to be developed under a contract R&D and manufacturing initiative with the U.S. government. And last year we were identified by the United States Centers for Disease Control and Prevention ("CDC") as being the only potential supplier of a botulinum toxin immune globulin. This manufacturing contract has not yet been awarded, but we remain confident that one will be, and that Cangene will be chosen to provide the product. Under earlier R&D contracts, we have already begun work on both this and an anthrax immune globulin. The U.S. Department of Health and Human Services ("DHHS") has awarded us a contract to supply anthrax immune globulin for preliminary efficacy testing, after which they have an option to place a larger order. Our most advanced infectious disease target, an immune globulin specific for hepatitis B virus, was submitted to Canadian and U.S. regulatory authorities some time ago and the files are under regulatory review.

We continue to investigate additional innovative products in our laboratories. Especially interesting is the development of a monoclonal antibody program. Monoclonals are specific antibodies that have been produced in the laboratory and offer the promise of targeting agents that are difficult to isolate from plasma. *Burkholderia* bacteria and the hemorrhagic fever-causing Ebola virus are examples of such targets. Industry reports suggest that the market for monoclonal antibodies is one of the most rapidly growing sectors of the pharmaceutical industry. We also continue to see promising data from our small-molecule technology project, and hope to share news about its therapeutic potential shortly.

On the recombinant protein side of our pipeline, there have not been any visible developments; however, behind the scenes our regulatory staff is readying our submission for human growth hormone. Leucotropin®, our GM-CSF product that was submitted in Canada last year, is also under active regulatory review. We believe a favourable inspection of our new manufacturing facility has moved us one step closer to the market, but it is difficult to predict when that might be.

ENDURING STRENGTHS

As I mentioned earlier, despite many positive developments, the financial results were disappointing this year. Why? There were several reasons:

- We had hoped that during fiscal 2005 we would have at least one significant new government contract to replace the completed VIG contract. However, supply contracts of that nature are complex, and both the bidding and negotiation processes take time. Although the CDC has identified us as the only potential supplier for an anti-botulism product, no contract has been negotiated yet.
- We changed our U.S. marketing and distribution partner for WinRho® SDF during the year, and while we believe this to be a good strategic move, the changeover did affect the flow of U.S. sales as warehouses were stocked in advance to ensure uninterrupted supply to patients.
- Our spending on research and development continued to climb significantly, due largely to the impact of contract-research agreements with the U.S. government and further development of our own product pipeline.
- Activities have been reduced at our Chesapeake Biological Laboratories, Inc. subsidiary as we concluded a major smallpox vaccine filling subcontract. We are currently negotiating with at least one viral-vaccine manufacturer regarding their potential future use of the specialized viral fill/finishing facility, but due to uncertainty in the outcome of these negotiations, we have recorded an impairment loss of \$18.0 million relating to this facility.
- Our revenues are collected mainly in U.S. dollars, so the strengthening Canadian dollar has negatively impacted foreign currency translation.

While the nature of our business often results in fluctuating revenues, particularly on the contract R&D and manufacturing side, we believe the downturn in our earnings caused by the above combination of factors is likely to be transitory. I believe it is important to continue focusing on our strengths and building the business for the future, rather than reacting to short-term results.

In this regard, we are continuing to pursue new contract development and manufacturing opportunities and our Government Business Development & Project Management group has been busy preparing proposals. Their success is evidenced by our growing VIG business and we hope to see additional agreements going forward.

Message to Shareholders (continued)



John Langstaff, PhD | 20 years' commitment | Recognized as a Distinguished Alumnus by the University of Winnipeg, John is a familiar face in the Manitoba science and technology community as well as Canadian biotech and pharmaceutical industries. With John as President and CEO, Cangene has grown significantly and continues to expand its businesses and build new facilities.

Vice President of Commercial Operations, which includes business development and maximizing opportunities in government contracting. John Vivash adds substantial experience with the investment industry, including 20 years of board experience, to our board of directors. His extensive familiarity with Canadian investment markets and securities regulation will be invaluable to our developing governance programs.

Lastly, we were proud to receive a bronze Human Resource Leadership Award from the Human Resource Management Association of Manitoba. Our employees are our greatest asset, and leading human resource programs are as important as leading science.

I look forward to an exciting year ahead and hope you will continue to follow Cangene's progress.

Dr. John Langstaff
President and Chief Executive Officer
September 30, 2005

As part of our ongoing development strategy, in January we reached an agreement with Scotiabank, our senior lender, to renew and expand our credit facilities. We've increased our operating line of credit from \$15 million to \$20 million and arranged a \$30-million building expansion facility to fund construction of a new plasma fractionation plant, which will double our fractionation square footage and triple our throughput capacity. Construction is well underway. We anticipate completion early next year and expect to have the operation fully furnished and validated during fiscal 2007.

Integral to all our operations are the committed people who support them. Two notable additions to Cangene during this fiscal year were Michael Graham, our new Chief Financial Officer who joined us in September 2004 and John Vivash, who joined our board of directors in June. Mike brought nearly 20 years of senior management and finance experience with public and privately held corporations. He is concentrating on finance, policy and corporate governance, while John McMillan, who had been acting CFO on an interim basis, assumed a more specialized role as

ENDURING SIGNIFICANCE

ANTIBODY-BASED PRODUCTS | *Smallpox has afflicted humankind throughout documented history. Anthrax was used as a biological weapon as far back as the Middle Ages. The World Health Organization estimates that nearly one-third of the world's population has been infected with hepatitis B.*

And the list keeps growing. Marburg virus was first identified in a human outbreak in 1967, followed by an epidemic of the closely related Ebola virus in 1976. West Nile virus, SARS and avian flu are relatively new additions to the world scene. Each year, new challenges emerge, standard therapies falter and medical science struggles to answer.

Cangene believes that hyperimmunes—purified antibody products—are one answer with sustainable efficacy. With technology based on the manufacture of its life-saving drug WinRho® SDF, Cangene has established itself as the developer and manufacturer of choice for new antibody products, with a growing cadre of biodefence and infectious-disease-targeted products.

Hyperimmunes can be used to provide a patient with immediate immunity, either when there isn't time to wait for an immune response to a vaccine or as a backup when the immune system isn't functioning sufficiently. The development time for hyperimmunes is often shorter than for chemically based drugs.



Esther Lo | 10 years' commitment | Esther's golden touch at the bench earned her a permanent position after a two-week student placement. A smiling contributor to every Cangene Mississauga social event, she's also helping to develop Cangene's monoclonal antibody technology as Research Technician in Protein Research.

Cangene's development of Vaccinia immune globulin ("VIG") took only 32 months from beginning the contract to approval by the U.S. Food and Drug Administration.

Many targets are possible for hyperimmunes, provided commercial quantities of plasma containing the antibodies of interest can be obtained. Vaccinated individuals or recovered patients can donate plasma. To expand its product opportunities, Cangene is developing a process for using plasma obtained from animal donors, which will be useful for targets where no human vaccine is available. As part of its innovative drug program, Cangene is also developing monoclonal antibody technology. This is a method for producing specific antibodies in the laboratory and obviates the need for plasma.

Cangene develops new hyperimmunes as it identifies need or through R&D contracts. This approach builds a strong product pipeline for long-term growth, while generating near-term revenue and minimizing development risk.

CONNIE GOMEZ, BSc | 18 years' commitment

As one of the early technicians manufacturing WinRho® SDF, Connie participated in all aspects of its production. This experience serves her well in her new position as Fractionation Manager, where she oversees plasma fractionation for WinRho® SDF and other hyperimmunes as well as formulation and scale-up for contract projects.



ENDURING SIGNIFICANCE

FLAGSHIP PRODUCT

WinRho® SDF

- key revenue generator for more than ten years
- responsible for most of Cangene's \$35-million biopharmaceutical product sales in 2005
- antibodies to a certain type of red blood cell, not an infectious agent
- used to prevent hemolytic disease of the newborn ("HDN") and treat ITP (a clotting disorder)
- sold in about 40 countries worldwide
- new U.S. distributor in 2005 aligns marketing with affiliated European distributor
- approval in ten European countries during fiscal 2005 through Mutual Recognition Procedure
- new liquid formulation approved in United States during 2005
- positive results seen in dengue hemorrhagic fever trial during 2005

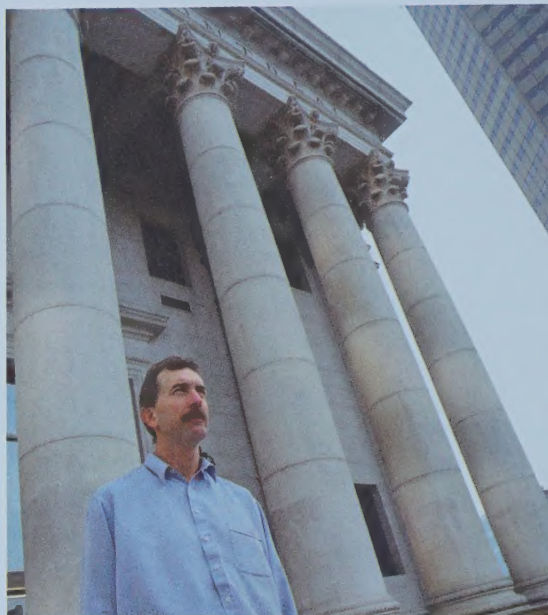
SIGNIFICANCE – more than three million pregnancies at risk for HDN treated. ITP is an autoimmune condition with largely unknown cause; incidence is three times higher in women

OTHER APPROVED OR FILED HYPERIMMUNES

Vaccinia immune globulin ("VIG")

- approved in United States during 2005
- antibody to virus used to make smallpox vaccine; used to counteract certain side effects that can arise from the vaccine
- original purchase by U.S. government drove Cangene's exceptional revenues in 2003; subsequent smaller contracts from Canadian and U.K. governments
- marketing agreement with Acambis plc outside North America and Israel

SIGNIFICANCE – thought eradicated in 1980, smallpox is re-emerging as a potential biological weapon; governments that stockpile smallpox vaccine may want an accompanying stockpile of VIG



Gerry Bazin, P. Mgr. | 25 years' commitment | Hired as Production Technician on the day WinRho® SDF received its first licence, Gerry has always been part of its commercial manufacture. As Director of Manufacturing, he now oversees manufacturing at Cangene's Canadian operation.

VariZIG™

- approved in Canada in 2001
- antibody to Varicella zoster, the virus that causes chicken pox
- used to prevent chicken pox during pregnancy
- niche market

SIGNIFICANCE – for non-immune pregnant women, chicken pox exposure carries elevated risk

HepaGam B™

- submitted to U.S. FDA and Health Canada for regulatory review
- antibody to hepatitis B virus; used to prevent hepatitis B infection
- virus transmitted by contact with blood or other bodily fluids from an infected person

SIGNIFICANCE – there are approximately 350 million chronically infected individuals worldwide; many of these will progress to cirrhosis of the liver or liver cancer

Antibody-based Products (continued)

IN DEVELOPMENT

Botulinum toxin immune globulin

- developing under R&D contract with CDC
- Cangene identified as the only potential supplier for an anticipated new contract by the CDC
- to counteract botulinum toxin (botulism), a powerful neurotoxin produced by *Clostridium botulinum* bacteria, usually encountered in improperly canned foods

SIGNIFICANCE – naturally occurring cases are rare, but identified in U.S. as a bioterrorism threat (Category A)

Anthrax immune globulin

- developing under contracts with CDC and DHHS
- for use as adjunct to antibiotic therapy in critically ill patients with anthrax (*Bacillus anthracis*) infection
- vaccinated military donors will provide plasma
- naturally occurring infection in certain animals; can be transmitted to humans, but does not spread person to person
- extremely stable spores can survive decades

SIGNIFICANCE – anthrax has a long history as a bioweapon due to stability and infectivity; identified in U.S. as a bioterrorism threat (Category A)

Burkholderia antibody

- monoclonal antibody project funded by the United States National Institute of Allergy and Infectious Diseases (“NIAID”; part of the U.S. National Institutes of Health)
- to treat or prevent infection by *Burkholderia*

SIGNIFICANCE – *Burkholderia* bacteria identified in U.S. as a bioterrorism threat (Category B); monoclonal technology reportedly one of fastest growing sectors of pharmaceutical industry

Ebola and Marburg antibodies

- monoclonal and hyperimmune development project with funding from the Canadian Chemical, Biological, Radiological and Nuclear

incident, Research & Technology Initiative (“CRTI”)

- to treat and prevent hemorrhagic fever caused by Ebola or Marburg viruses
- animal reservoir for virus between human outbreaks is unknown

SIGNIFICANCE – can be transmitted from person to person; have a high percentage of mortality and bioterrorism potential (Category A); monoclonal technology reportedly one of fastest growing sectors of pharmaceutical industry

Ricin immune globulin

- collaborative monoclonal and hyperimmune project with Twinstrand Therapeutics Inc. and funding from CRTI
- to counteract ricin, a deadly plant-derived toxin
- no known antidote to toxin

SIGNIFICANCE – ricin reached world notice in 1978 with its reported use in assassinating exiled Bulgarian Georgi Markov; identified in U.S. as a bioterrorism threat (Category B)

West Nile virus immune globulin

- to treat and prevent infection by West Nile
- virus spread by mosquitoes after feeding on infected birds
- virus first isolated in 1937; first outbreak in North America in 1999

SIGNIFICANCE – virus reported in nearly every U.S. state in 2005; elderly patients at greatest risk

SARS immune globulin

- agreement with Health Canada and NIAID
- to treat or prevent infection by the virus associated with SARS
- transmitted through close person-to-person contact

SIGNIFICANCE – SARS was first reported in Asia in February 2003 and within just a few months it spread to more than two dozen countries. The World Health Organization reports 8,098 people became ill with SARS and nearly 10% of those died.

ENDURING RELATIONSHIPS

CONTRACT R&D AND MANUFACTURING | *Keeping existing customers is more valuable than finding new customers. And in the pharmaceutical industry the fewer changes that occur in your manufacturing the better, so being able to offer potential customers a full range of capabilities, from R&D to commercial-scale manufacturing and finished-product filling, differentiates one contract organization's services from the competitor's.*

"Why can't other partners provide me with the level of assistance and fast service that I am used to from Cangene? I could go hiking, fishing, skating, etc. in my free time", wrote one of Cangene's contract-manufacturing customers. Cangene provides customer service along with specialized facilities and years of manufacturing experience to a broad range of customers, with some relationships going back seven to ten years. New customers are attracted by Cangene's compliance with global standards, its FDA-licensed manufacturing operation and its established reputation. Several substantial development or manufacturing contracts with the U.S. government have established Cangene's credentials as a quality supplier, and its size allows its relationships to grow as the customer progresses toward commercial production. Specialized personnel in the Contract Services, and Government Business Development & Project Management groups help the Company work effectively with each type of customer through all stages of the process.

In addition to its original hyperimmune manufacturing plant, Cangene's new biotechnology manufacturing facility is a fully Good Manufacturing Practices-compliant fermentation operation, allowing the Company to offer small-scale mammalian-cell manufacturing or large-scale microbial fermentations. It is the only Canadian company that can offer the full range of services from fermentation to finished-product preparation. Cangene's customer base includes companies at various stages of development.

Cangene's Chesapeake Biological Laboratories, Inc. subsidiary in Baltimore, Maryland offers facilities for filling and finishing process-sensitive biologics. Chesapeake's specific capabilities for sterile filling vials and syringes complements Cangene's expertise in developing new products and manufacturing using sophisticated technologies.

For Cangene, providing contract R&D and manufacturing services generates revenue independent of the regulatory process, which diminishes long-term risk. It also enriches product and technology development opportunities, thus supplementing existing skills and ultimately benefiting its own pipeline.

Contract R&D and manufacturing generated 48% of the Company's revenue in 2005, even in the absence of any large government contracts. While the nature of its contract business can result in an uneven revenue flow, the benefits are nevertheless substantial. With its solid reputation with major customers, Cangene anticipates growth in this segment as the demand for validated manufacturing capacity and specialized products continues to grow throughout the industry and across governments.

DAVID YOUNG, MSc | 20 years' commitment

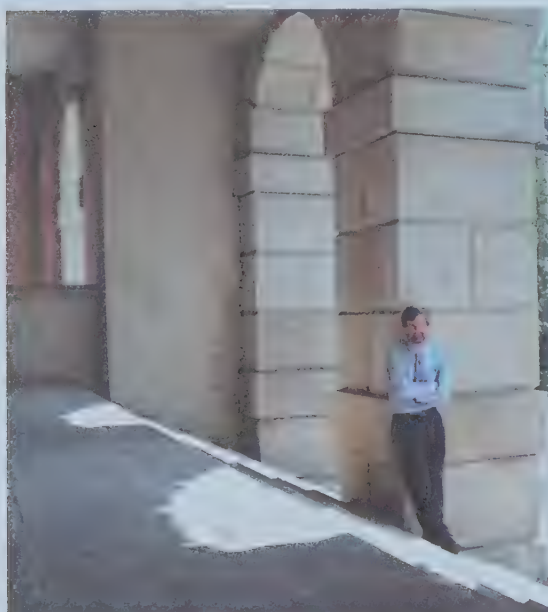
Dave's done it all—R&D, process development, manufacturing, and sales and marketing, so he's well equipped for his position as Sales Manager, Contract Manufacturing. His comprehensive background gives him intimate understanding of a customer's needs so he can help Cangene deliver a full range of services.



FOLLOW-ON BIOPHARMACEUTICALS | *Successful generic drugs must offer qualities the market wants in the face of newly introduced products. Technology used to make them must be cost-effective and efficient. And in the case of biologics, the company that makes them must be willing to shepherd them through an evolving regulatory process.*

But the potential rewards make the challenge worthwhile. Billions of dollars worth of biological products are beginning to come off patent, and consumers deserve to have expanded access to these life-saving drugs. The United States Food and Drug Administration has indicated its intention to prepare draft guidance for the development of follow-on protein pharmaceutical products, and held workshops

to discuss the issue with industry. The European Medicines Agency is already moving cautiously ahead with guidelines for determining the comparability of medicinal products containing biotechnology-derived proteins as active substances, and certain jurisdictions are allowing marketing of such products. Advances in analytical technology continue to diminish the difficulty of comparing complex biological products.



Donald Stewart, PhD | 20 years' commitment | Don was here at Leucotropin®'s beginning; he was instrumental in developing its manufacturing process and its clinical evaluation, and is still acknowledged as the local authority. As Director Research, he evaluates new product and collaborative research opportunities, especially in areas of recombinant proteins and monoclonal antibodies.

Cangene has a long history of expertise developing and using recombinant protein technology to produce therapeutic products. Years ago, it decided to take the unconventional approach of channelling this expertise into developing follow-on proteins, its own version of recombinant products that are already commercially successful, making the Company well positioned to enter this emerging market.

Cost-conscious healthcare systems will welcome cheaper alternatives to expensive protein-based drugs and Cangene has developed proprietary expression systems—the cell-based technology used to synthesize human proteins—that produce high-quality proteins, cost-effectively.

Cangene's majority shareholder, the Apotex Group, is a leading Canadian generic drug company and has supported the development of certain products in Cangene's biopharmaceutical pipeline for several years. Cangene achieved a significant milestone last year when it submitted its first recombinant protein biopharmaceutical for regulatory review in Canada.

Follow-on Biopharmaceuticals

PRODUCTS IN DEVELOPMENT

Leucotropin®

- submitted in Canada for enhancing recovery of patients with Hodgkin's disease and non-Hodgkin's lymphoma following stem-cell transplantation; under active regulatory review
- investigating use as therapy for white-blood-cell damage resulting from radiation exposure, with funding from the Canadian government's Chemical, Biological, Radiological and Nuclear incident, Research & Technology Initiative ("CRTI")
- a protein called granulocyte-macrophage colony-stimulating factor ("GM-CSF")
- naturally stimulates the production of certain white blood cells, which are important components of the immune system and can be depleted by chemotherapeutic agents and radiation, leaving patients susceptible to infections
- further investigating a form of chemical modification (PEG-GM-CSF) that may improve pharmacological properties, also a CRTI project

Human growth hormone

- preparing U.S. regulatory filing
- naturally promotes growth of long bones before puberty
- several marketed versions of this protein share a very large market
- BioGeneriX AG, a subsidiary of one of Europe's leading generic companies, will pursue regulatory approval and subsequent marketing in Europe under exclusive agreement



Angela Sterner, BSc (Hons.) | 12 years' commitment | DNA to Teddy Bears' picnics—Angela's contribution to Cangene is wide-ranging. She helped develop cell lines such as those used in hGH production, and as Research Technician in Assay Development she assays material for biopharmaceutical expression. As a ten-year member of the social committee, she has organized numerous charitable events and company functions.

PRODUCT PIPELINE

PRODUCT	DESCRIPTION	INDICATION
WinRho® SDF	Hyperimmune: Purified antibody specific for Rh+ red blood cells (also called anti-D immunoglobulin)	Preventing hemolytic disease of the newborn and treating ITP (an autoimmune platelet disorder)
WinRho® SDF (dengue hemorrhagic fever)	Hyperimmune: Purified antibody specific for Rh+ red blood cells (also called anti-D immunoglobulin)	Treating dengue hemorrhagic fever
VariZIG™	Hyperimmune: Purified antibody specific for Varicella zoster virus (chicken pox virus)	Preventing chicken pox during pregnancy
HepaGam B™	Hyperimmune: Purified antibody specific for hepatitis B virus	Preventing hepatitis B infection
Vaccinia immune globulin	Hyperimmune: Purified antibody specific for Vaccinia virus (the virus used to make smallpox vaccine)	Treating and preventing severe reactions that may accompany smallpox vaccinations
Botulinum toxin immune globulin	Hyperimmune: Purified antibody specific for botulinum toxin (botulism anti-toxin)	Treating botulism
Anthrax immune globulin	Hyperimmune: Purified antibody specific for <i>Bacillus anthracis</i> , the bacteria that cause anthrax	Treating critically ill people who have anthrax
West Nile immune globulin	Hyperimmune: Purified antibody specific for West Nile virus	Treating and preventing West Nile infection
Ricin immune globulin	Hyperimmune: Purified antibody specific for ricin toxin (deadly plant-derived toxin)	Treating ricin poisoning
SARS immune globulin	Hyperimmune: Purified antibody specific for the virus associated with SARS	Treating SARS
Ebola/Marburg antibodies	Hyperimmune and monoclonal antibodies to Ebola or Marburg viruses	Treating and preventing hemorrhagic fever caused by Ebola or Marburg viruses
Burkholderia antibody	Monoclonal antibody to <i>Burkholderia</i> bacteria	Preventing infection with <i>Burkholderia</i> bacteria
Leucotropin® (cancer)	Biopharmaceutical: Granulocyte-Macrophage Colony-Stimulating Factor ("GM-CSF"), a protein that enhances mature, infection-fighting white-blood-cell production	Enhancing mature white-blood-cell production in stem-cell transplantation for cancer patients
Leucotropin® (radiation)	Biopharmaceutical: GM-CSF, a protein that enhances mature, infection-fighting white-blood-cell production	Treating radiation exposure
Human growth hormone	Biopharmaceutical: a protein that promotes growth of long bones before puberty	Growth hormones are used to treat growth hormone deficiencies, Turner syndrome in girls, wasting and various other metabolic conditions



MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

October 12, 2005

This review contains management's discussion of the Company's operating results and financial condition for the year ended July 31, 2005, and should be read in conjunction with the accompanying audited financial statements and associated notes.

Disclosure controls and procedures

Management has established and maintained disclosure controls and procedures for the Corporation in order to provide reasonable assurance that material information relating to the Corporation is made known to it in a timely manner, particularly during the period in which the annual filings were being prepared. Management has evaluated the effectiveness of the Corporation's disclosure controls and procedures as of the date of this report, and believes them to be effective in providing such reasonable assurance.

Forward-looking statements

Management's discussion and analysis contains certain forward-looking statements that are subject to risks and uncertainties that may cause actual results or events to differ materially from the results or events predicted in this discussion. These risks and uncertainties include, but are not limited to, those discussed in the RISKS AND UNCERTAINTIES section within this MD&A. Forward-looking statements can be identified by the use of words such as "expects", "plans", "will", "believes", "estimates", "intends", "may", "bodes" and other words of similar meaning. Should known or unknown risks or uncertainties materialize, or should management's assumptions prove inaccurate, actual results could vary materially from those anticipated.

OVERVIEW

Cangene Corporation ("the Company" or "the Corporation") is a Canadian biopharmaceutical company in the business of developing, manufacturing, and commercializing products and technologies for global markets. Revenues are generated by product sales, contract manufacturing, contract research and development, and royalties. The Company manages its business and evaluates performance based on two operating segments: biopharmaceutical operations, and contract R&D and manufacturing. International sales are transacted mainly in U.S. dollars.

Cangene is developing two different categories of products: hyperimmunes, which are concentrated specialty antibody preparations made from plasma, and recombinant biopharmaceuticals, which are therapeutic proteins made by introducing a particular gene into a host organism, which in turn produces the protein of interest. The Company has particular expertise in manufacturing technologically complex and sterile injectable products, and also offers contract R&D and manufacturing services to other biopharmaceutical organizations.

In addition, Cangene has an ongoing innovative R&D program, providing further opportunities for long-term growth.

Cangene's first licensed product was WinRho[®], and its development established a core competency in developing and manufacturing hyperimmunes. Two additional hyperimmune products, VariZIG[™] and Vaccinia immune globulin ("VIG") have also been licensed. A hepatitis B immune globulin has been filed for regulatory review.

Cangene is also developing certain recombinant biopharmaceutical products as follow-on biologics (a similar strategy to that of traditional generic drugs). The Company has filed in Canada for regulatory approval of its leading product in this category, Leucotropin[®] ("GM-CSF"), and expects to file an application for its second follow-on product, human growth hormone, in the U.S. in the coming months. Much of this work is supported by an R&D agreement with the Apotex Group, which includes Apotex Holdings Inc., Apotex Inc. (a leader in the Canadian drug industry), Apotex Research Inc. and other subsidiaries. The Apotex Group is indirectly controlled by Bernard Sherman and holds approximately 80% of Cangene's common stock at October 12, 2005.

Revenues from the biopharmaceutical operations segment are largely derived from sales of WinRho[®] SDF, which has been sold in more than 40 countries. Cangene continues to seek additional geographic markets for WinRho[®] SDF, while also making efforts to increase penetration in existing markets through new distribution relationships and investigating use of the product in new patient populations.

In December 2004, WinRho[®] SDF was licensed in 10 European countries through the Mutual Recognition Procedure ("MRP") based on earlier licensing in the U.K. In conjunction with its European distribution partner, Baxter Healthcare S.A., the Company is preparing additional MRP filings for several more jurisdictions where a significant market opportunity exists.

In 2005, Cangene selected Baxter Healthcare Corporation, an affiliate of the Company's European distribution partner, as its new WinRho[®] SDF distributor for the U.S. in order to align its international marketing efforts and potentially increase penetration in the competitive U.S. market.

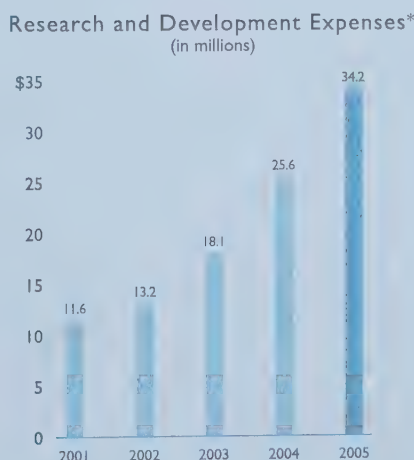
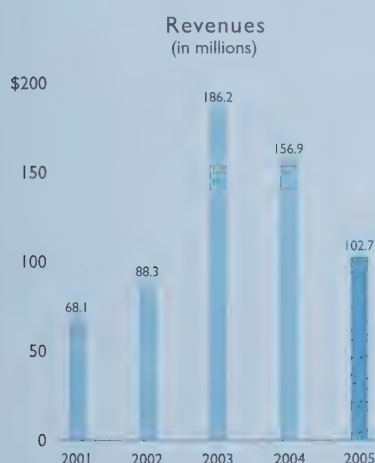
Shortly thereafter, the Company received approval to market a liquid formulation of WinRho[®] SDF in the U.S., which could increase market acceptance due to increased ease of use. The Company will continue to employ similar market expansion strategies for other hyperimmunes and its recombinant products as they move through the development pipeline.

Cangene has leveraged its capability to develop and manufacture hyperimmunes into a contract R&D and manufacturing business. The Company has been awarded several contracts to develop and manufacture certain biodefense and infectious-disease-related products for the U.S. government. The largest of these was a contract to develop and manufacture VIG, a product used to counteract certain side effects of smallpox vaccination. Cangene submitted a Biological License Application ("BLA") for VIG to the United States Food and Drug Administration ("FDA") at the end of July 2004. The application was given fast-track designation, and was subsequently approved in May 2005. Cangene has already manufactured and delivered an initial supply of VIG under the five-year supply-and-development agreement with the United States Centers for Disease Control and Prevention ("CDC") that began two years ago. Immune globulins aimed at botulinum toxin (botulism) and anthrax are also being developed under R&D contracts with the U.S. government. These may also lead to supply contracts.

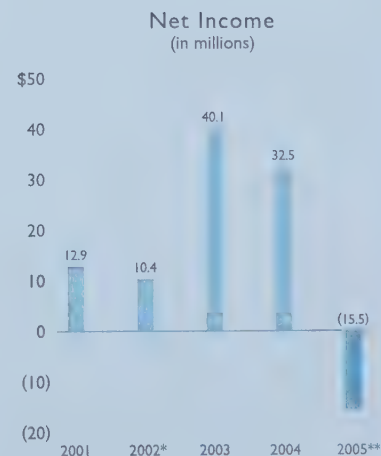
Cangene's specialized facilities and manufacturing experience allow it to offer contract R&D and manufacturing services for a broad range of technologically complex, process-sensitive compounds in addition to hyperimmunes. The Company's Chesapeake Biological Laboratories, Inc. ("Chesapeake") subsidiary in Baltimore, Maryland offers facilities for filling and finishing process-sensitive biologics. One of these, a viral vaccine-filling facility, was instrumental in Chesapeake securing a portion of the U.S. government smallpox vaccine contract in a prior year.

The contract R&D and manufacturing segment continues to contribute significant revenues to the overall business; however, this segment is subject to large fluctuations in activity as contracts are completed and new contracts initiated. During fiscal 2004, contract R&D and manufacturing revenues declined 28% as the Company completed supplying the initial order for the VIG contract part way through that year and the Chesapeake operation faced weaker customer demand. Contract manufacturing revenue declined further in fiscal 2005 as Chesapeake completed, early in the year, the significant subcontract to fill/finish smallpox vaccine for the primary U.S. government supplier, and no new major contract orders were received. Revenues were also affected as the U.S. dollar weakened in relation to the Canadian dollar. Cangene is aggressively pursuing new contract R&D and manufacturing opportunities, including potential contracts with the U.S. government to develop and supply products under the *Bioshield Act*. These contracts, if awarded, would provide Cangene with revenues from the development and supply of products over the next few years as biodefense stockpiles are built, and could provide potential to expand product sales to other governments. The Company is currently marketing the VIG product to other governments and has experienced early success. Cangene also seeks contract R&D and manufacturing agreements with biopharmaceutical industry partners, particularly at its Chesapeake subsidiary.

SELECTED ANNUAL INFORMATION



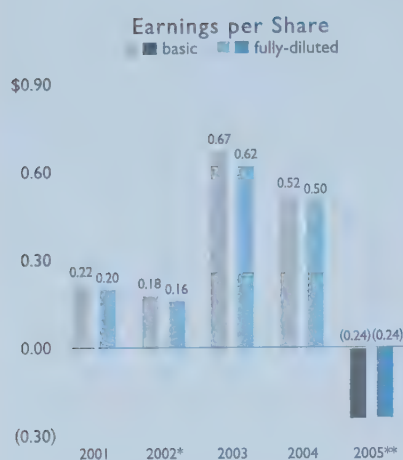
* After applying investment tax credits



* Includes a \$5.0-million charge against goodwill

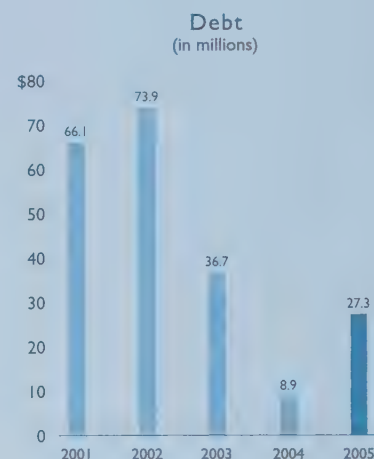
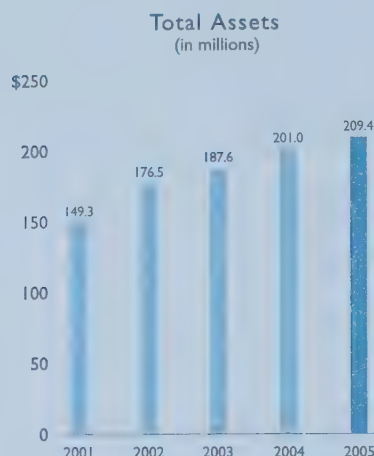
** Includes an \$18.0-million non-cash impairment loss related to the Chesapeake facility

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)



* Reflects a \$5.0-million charge against goodwill

** Reflects an \$18.0-million non-cash impairment loss related to the Chesapeake facility



The selected annual information presented above and on page 17 is extracted from the Company's audited financial statements, which are prepared in accordance with Canadian generally accepted accounting principles and reported in Canadian dollars. A significant portion of the Company's revenues are denominated in U.S. dollars and the Company has significant operations in the U.S., requiring translation of these revenues and operations to the reporting currency.

Revenue fluctuations within the contract R&D and manufacturing segment, as discussed above, coupled with increased research and development activities aimed at expanding the Company's product pipeline, have contributed to fluctuations in profitability over the last five years. In the period from fiscal 2000 through 2002, the Company's profitability primarily resulted from WinRho® SDF sales in the biopharmaceutical segment. Net income in fiscal 2002 was reduced as a result of recording a \$5.0-million goodwill impairment charge related to the Chesapeake contract-manufacturing operation. The dramatic increase in revenue and earnings in 2003 resulted directly from the VIG contract in the Canadian operations and the smallpox vaccine fill/finish subcontract at Chesapeake. In fiscal 2004, the Company completed supplying the initial order for the VIG contract midway through the year. At the same time, the volume of fill/finishing activity for smallpox vaccine at Chesapeake was diminishing as that contract neared completion. Consequently, contract-manufacturing volume declined in 2004. However, the number and magnitude of contract-research and development projects, along with Cangene's own new product research and development efforts, increased, causing a rising trend in research and development expenditures and related contract revenues. These trends continued in fiscal 2005, with a continued decline in contract-manufacturing activity coupled with increasing investment in research and development, especially focused on biodefence-related R&D contracts. Earnings per share over the period reflects the fluctuations in earnings, while the number of shares outstanding has grown gradually over the period, due to the exercise of stock options.

NEW DEVELOPMENTS

In August 2004, the Company announced that it would process plasma to be collected from anthrax-vaccinated military personnel. The U.S. Department of Defense announced it will support a Health and Human Services ("DHHS") and CDC effort to create a new antibody-based medication against anthrax. An anthrax immune globulin ("AIG") could become a critical medical countermeasure in the event of an anthrax attack. This was an expansion of an earlier contract with the CDC. The Company subsequently submitted proposals to the DHHS and the CDC for an AIG supply agreement. Subsequent to the year end, late in September 2005, Cangene was awarded a contract by the Office of Public Health Emergency Preparedness, in the office of the Secretary of the DHHS, to supply Cangene's AIG to be used for preliminary efficacy testing. Based on the outcome of this testing and several other factors, the DHHS has an option, within a year of the award date, to purchase between 10,000 and 100,000 doses of AIG over a period of three years. If the DHHS exercises this option, Cangene will be required to undertake the steps necessary for licensure by the U.S. FDA.

Also in August 2004, Cangene began recruiting patients for a clinical trial to investigate WinRho® SDF in a new patient population. This trial built on findings from a pilot study that indicated administration of WinRho® SDF may improve patient survival in cases of dengue hemorrhagic fever ("DHF"). Both trials were conducted in the Philippines where DHF creates a severe healthcare burden. DHF causes increased blood vessel permeability resulting in plasma loss, decreased levels of blood platelets, and hemorrhagic tendencies. The disease can kill through circulatory failure and shock. Cangene announced on February 15, 2005, that analysis of interim data collected from the study indicated the primary endpoint of the trial had been met. Ninety percent of patients receiving WinRho® SDF responded. These results suggest that WinRho® SDF may be an effective treatment for other infectious diseases that can cause dangerously low platelet counts, and which may have greater market potential.

In September 2004, Mr. Michael Graham joined Cangene as its new Chief Financial Officer. Mr. Graham, a Chartered Accountant, has nearly 20 years of senior management and finance experience with public and privately-held corporations. Mr. John McMillan, who had been interim CFO since the retirement of Mr. Alex Glasenberg in February 2004, continues with his responsibilities for sales, marketing and business development as Vice President of Commercial Development.

In October 2004, Chesapeake completed the fill/finishing subcontract with the supplier of smallpox vaccine to the U.S. government. Cangene and Chesapeake are currently assessing new contract manufacturing opportunities for the specialized viral fill/finishing facility, which is temporarily idle. The U.S. government announced in July 2005 that it intends to purchase an additional 80 million doses of smallpox vaccine over the next five years. Chesapeake is well positioned as a potential subcontractor to at least one of the parties that may compete for this new smallpox vaccine contract.

Also in October, the Company reported that the CDC intends to negotiate a sole-source agreement with Cangene to provide up to 200,000 doses of botulinum toxin immune globulin. Negotiations on this development and manufacturing contract are underway; however, no contract has yet been awarded. The Company expects that such a contract would follow on an earlier research contract, under which Cangene is completing initial development and testing of a botulinum toxin immune globulin.

In December 2004, the Corporation successfully completed the European Mutual Recognition Procedure ("MRP") for the approval of WinRho® SDF in ten European countries for use in preventing hemolytic disease of the newborn and treating a clotting disorder called ITP. As a result, WinRho® SDF can be launched in Belgium, Finland, Greece, Iceland, Ireland, Italy,

Luxembourg, Norway, Portugal and the Netherlands. WinRho® SDF was approved in the United Kingdom in 1999. The newly approving European Union countries mutually recognized the U.K. licence after completion of the MRP. Cangene's European distribution partner, Baxter Healthcare S.A., will undertake the launch and marketing in these countries. Cangene plans to follow the same process for approval in additional EU member states in the future.

In January 2005, the Company reached agreement with its senior lenders to renew its credit facilities, including increasing the operating line of credit from \$15 million to \$20 million. The renewal also included a new \$30-million, non-revolving term loan facility to be used for further development of its plasma fractionation plant capacity. The Company expects to draw on the expansion facility over the period through September 2006, after which the term loan will become repayable in monthly instalments over five years.

In early March 2005, the Company was awarded a contract by the Health Canada Centre for Emergency Preparedness and Response to supply VIG and seek its licensure for the treatment of certain complications that can result from vaccination against smallpox. The value of the contract was approximately \$3.2 million; the product was delivered during the third quarter of fiscal 2005.

Effective March 28, 2005, Baxter Healthcare Corporation ("Baxter"), an affiliate of Cangene's European distribution partner, assumed exclusive rights to market and distribute WinRho® SDF in the United States following the expiry of Cangene's distribution agreement with Nabi Biopharmaceuticals. The Company believes that having the same distributor in the two major markets will enhance its worldwide marketing efforts and allow better coordination of sales and inventory.

In April 2005, the FDA approved the liquid formulation of WinRho® SDF. The liquid formulation provides an important alternative to the lyophilized (freeze-dried) product, eliminating the need for reconstitution prior to administration and increasing the convenience for physicians. Baxter intends to launch the new liquid formulation in the U.S. later in 2005.

In May 2005, the FDA also approved the VIG hyperimmune product for licensure. VIG is the first of Cangene's biodefence products to receive approval and the Company was able to reach this goal only nine months after the drug's submission, representing a significant milestone in the Company's biodefence strategy. The Company believes that having an FDA licence for VIG in the U.S. will enhance the product's international marketability and, subsequent to the fiscal year end, the U.K. Department of Health awarded Cangene a contract to supply VIG. The contract has an estimated value of

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

approximately \$17.0 million. Cangene expects to complete delivery during fiscal 2006. The U.S. Department of Defense has indicated it intends to contract with Cangene as the sole source for a supply of VIG for a period of up to five years.

In June, the Company announced the addition of Mr. John Vivash to its board of directors. Mr. Vivash has substantial experience in the investment industry, including 20 years of board experience. From 1954 to 1987 he held various investment dealer positions, up through director and vice president. Since then, he has served as president and CEO of Fidelity Investments Canada Limited (1987–1989), CIBC Securities Inc. (1990–1995) and Manulife Securities International (1995–1997). Currently, and since 1989, he has been president and CEO of Tesseract Financial Inc., a financial services consulting company he founded. In addition, Mr. Vivash has participated on committees for the Toronto, Montreal and Vancouver Stock Exchanges, and the Ontario Securities Commission. He has lectured at the Universities of Alberta, Toronto and Western Ontario (Ivey School of Business), and given more than 500 investment seminars and lectures in Canada, the United States and Europe. Mr. Vivash has participated on more than 20 boards of directors in Canada and abroad.

RESULTS OF OPERATIONS

Revenues

Total revenues, consisting of revenues from the biopharmaceutical, and contract R&D and manufacturing operating segments, for the year ended July 31, 2005, were \$102.7 million, compared to \$156.9 million in the prior year. Within each operating segment, revenues may include product sales and service revenues derived from the manufacture and delivery of products, R&D revenues derived from research and development activities and services, and royalties derived from intellectual property rights to products produced and sold by Apotex or other third parties.

Revenues from the biopharmaceutical operations segment were \$53.7 million in the current year compared to \$65.7 million last year. Growth in WinRho® SDF sales in international markets and an increase in research revenues related to biopharmaceutical products being developed jointly with Apotex only partly offset weaker sales in the U.S. and the impact of the weaker U.S. dollar as Cangene transitioned its U.S. distribution from Nabi Biopharmaceuticals to Baxter.

Product sales within the biopharmaceutical segment in fiscal 2005 were \$35.0 million, down from \$48.8 million in the prior year, reflecting the weaker WinRho® SDF sales in the U.S. and the weaker U.S. dollar. R&D service revenues in this segment increased to \$12.8 million in 2005, compared to \$9.3 million in the prior year, as Cangene scaled up joint research projects

with Apotex for two follow-on generic recombinant protein products, Leucotropin® and human growth hormone.

Royalty revenues declined to \$5.9 million in the current year, from \$7.6 million last year, on reduced sales of Ferriprox™ (deferiprone), a drug manufactured and marketed by Apotex for which Cangene receives 50% of net profits due to an earlier agreement.

Contract R&D and manufacturing revenues were \$49.1 million in fiscal 2005, compared to \$91.2 million in the prior year. Cangene produced and delivered \$42.3 million of VIG product under contract to the CDC last year, compared with VIG contract revenue of \$3.5 million in the current year. In addition to the effect of completion of the VIG manufacturing contract, other contract-manufacturing revenues declined from \$22.7 million last year to \$17.2 million, which includes the impact of the current year's reduced contract viral fill/finishing activities at Chesapeake.

Contract-R&D revenues for fiscal 2005 were \$28.3 million, compared to \$26.2 million in the prior year. Within the contract R&D and manufacturing segment, two significant research and development projects with the CDC contributed significantly to R&D revenue and costs during 2005. The first was an expansion of a contract awarded by the CDC in 2003 to develop a clinical-grade hyperimmune targeted at anthrax. The second relates to a contract to develop a clinical-grade hyperimmune to counteract botulinum toxin that was awarded to Cangene in 2003, also by the CDC. During the current year, in addition to working on these two contracts, the Company was completing contract-research work under the VIG contract with the CDC, and conducting ongoing contract research for the Apotex Group and other third parties relating to products that are not a part of Cangene's pipeline. The Company expects to continue to incur expenditures and record revenue in respect of the anthrax and botulinum R&D contracts with the CDC during fiscal 2006.

The Company anticipates that contract R&D and manufacturing revenues may continue to fluctuate in the future, depending on whether significant new manufacturing contracts with the U.S. or other governments are awarded.

Cost of sales – product sales and services

Cost of sales for the year ended July 31, 2005 decreased to \$34.3 million or 62% of product sales and service revenues compared to \$65.1 million or 57% of product sales and service revenues in the prior year, due to the reduced volume of manufacturing activity. Gross profit from product sales and services declined from \$48.7 million last year to \$21.4 million in the current year in absolute dollar terms, while the margin as a percentage of product sales and service revenues was 38%, down from 43% for the same period last year.

Gross profit earned on product sales and service revenues in the biopharmaceutical segment was \$23.5 million or 67% of revenue, compared to \$36.8 million or 75% of revenue in the prior year. It was negatively impacted by the shift in WinRho® SDF sales mix out of the U.S. and into international markets where margins are typically lower.

In the contract R&D and manufacturing segment, reduced contract production volumes of VIG in Canada and reduced viral vaccine fill/finishing activities at Chesapeake contributed to a loss of \$2.1 million at the gross profit level in fiscal 2005, compared to gross profit of \$11.9 million in the prior year, based on product service revenues from this segment.

Cost of sales – R&D services

The Company's research revenues are derived through agreements with Apotex as well as through research contracts with other parties, including the U.S. government. Research and development expenditures that relate to these sources of research revenues are classified as Cost of sales – R&D services.

Cost of sales – R&D services for fiscal 2005 increased to \$27.2 million, an increase of approximately 46% compared to \$18.6 million last year.

Cost of sales – R&D services in the biopharmaceutical segment increased to \$8.8 million in the current year, compared to \$7.3 million in 2004, as the Company continued developing the two follow-on generic products for which Cangene is receiving research revenues from Apotex. The increased research and development costs reflect increased research activity in the current year and higher per-unit overhead costs of products used for research purposes. Gross profit on research activities in the biopharmaceutical segment in fiscal 2005 was \$4.0 million or 31% of research revenue, compared to \$2.0 million or 22% of revenue last year. The improved margin in the current year is due to a greater proportion of research costs eligible for recovery through investment tax credits.

Cost of sales – R&D services in the contract R&D and manufacturing segment increased to \$18.4 million in fiscal 2005, compared to \$11.3 million in the prior year, due principally to the impact of the three contract-research agreements with the CDC. Gross profit on research activities in the contract segment totalled \$10.0 million or 35% of R&D revenues, compared to \$15.0 million or 57% of revenues in the prior year. Reduced margins in the current year reflect increased pressure on margins in more recent contract research negotiations, coupled with a greater proportion of these research expenditures ineligible for recovery through investment tax credits.

Independent R&D

Independent R&D expenditures, from which no related research revenue is derived, were \$7.0 million in fiscal 2005, unchanged from the prior year. Cangene continues to conduct independent research in several related biopharmaceutical fields, ranging from expanding applications of hyperimmunes to innovative research into entirely new therapies.

Selling, general and administrative expense ("SG&A")

Total SG&A expense for fiscal 2005 increased to \$16.4 million, compared with \$9.7 million in the prior year. Additional general and administrative expenses, totalling \$6.7 million, include legal and accounting costs of preparing contract proposals for certain U.S. government contracts, increased consulting and regulatory filing fees, property tax increases resulting from recent reassessments charged on the Company's Canadian manufacturing facilities, separation costs arising from staff reductions at Chesapeake, and the recording of stock option expense. The Company anticipates that these types of additional expenditures, other than separation costs and stock option expense, will continue in future periods at reduced levels.

Amortization

Amortization for the year ended July 31, 2005 increased to \$9.4 million from \$7.0 million a year ago. Higher amortization costs reflect increased investment in plant and equipment for both research and manufacturing, primarily in the biopharmaceutical operations. A recent expansion of the biopharmaceutical manufacturing facility came on-stream early in the new fiscal year and the Company is now amortizing this asset.

Interest

Interest costs in fiscal 2005 were \$0.9 million, compared to \$0.8 million in the prior year. Higher interest rates were partly offset by a lower average balance of total debt outstanding under the Company's credit facilities in the current year when compared to fiscal 2004. A significant balance of long-term debt was outstanding and repaid late in fiscal 2004, while in 2005, the operating line of credit has increased in response to the slowdown in contract-manufacturing business. The Company did not employ interest rate hedging during the current year, allowing outstanding bank debt to generally float at short-term market rates of interest.

Foreign exchange

Foreign exchange gains in fiscal 2005 were \$0.7 million compared to \$2.5 million in the prior year. Foreign exchange gains arise on translation of the integrated foreign subsidiaries' operations, as well as translation of foreign-currency-denominated loans and other balances in the accounts of the Canadian company. Higher foreign exchange gains in the prior year reflect the greater degree of strengthening of the Canadian dollar during the prior year, when compared to fiscal 2005.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Facility impairment loss

In 2002, Chesapeake, the Company's U.S. subsidiary, completed the design and construction of a specialized facility to fill and finish live viral vaccines after being named as a subcontractor to a significant contract between the primary contractor and the U.S. government for the supply of smallpox vaccine. Chesapeake completed the fill/finish contract in October 2004 and has been actively pursuing other potential contracts and customers that may have a need for this specialized manufacturing capability. In efforts to minimize the financial impact of maintaining this facility during fiscal 2005, certain utilities and components were decommissioned in late 2004. Although negotiations are continuing with at least one viral vaccine manufacturer for the potential future use of this facility, there can be no assurance that Chesapeake will be successful in securing future business for this specialized manufacturing capability, or that such future business, if secured, will be sufficient to operate this facility profitably. Accordingly, the Company has recorded an impairment loss relating to this facility of \$18.0 million, excluding equipment that the Company has determined could be used within its other manufacturing operations.

Income taxes

Income tax expense for the year ended July 31, 2005 decreased to \$5.6 million from \$18.7 million in the prior year. Lower income tax expense results from lower taxable income for the year. The effective rate of tax increased due to the Company's decision to record an impairment loss relating to viral vaccine fill/finish facility, for which no future tax benefit was recorded,

and the Company's decision to defer any further recognition of future recoveries of U.S. tax losses, beyond such losses incurred through January 2005.

Net income (loss)

Net loss for the year ended July 31, 2005 was \$15.5 million, compared to net income of \$32.5 million recorded for the prior year. Net loss in the current year was primarily due to lower WinRho® SDF revenue in the U.S. and reduced contract-manufacturing activity, including the impact of the impairment loss recorded relating to the viral vaccine facility. Increases in research and development expenditures, SG&A costs and amortization, partially offset by lower tax expense, also contributed to lower earnings.

Basic and diluted earnings (loss) per share

Basic loss per share for the year ended July 31, 2005 was \$0.24 per share compared to earnings of \$0.52 per share last year, reflecting the effect of reduced net earnings and an increase in the number of common shares outstanding. Diluted loss per share was \$0.24 per share for the current year, compared to earnings of \$0.50 per share in the prior year. Diluted earnings (loss) per share is calculated under the treasury stock method, which assumes that all outstanding stock options, where the exercise price is less than current market price, are exercised and the proceeds of such exercises are used to repurchase shares at the current market price. For the current year, the calculation of loss per common share on a fully-diluted basis excluded all potential common shares because the effect of including these shares would be to reduce the loss per share.

SUMMARY OF QUARTERLY RESULTS

Quarters ended in thousands of Canadian dollars except per-share data	July 31, 2005 (Q4 2005)	April 30, 2005 (Q3 2005)	January 31, 2005 (Q2 2005)	October 31, 2004 (Q1 2005)	July 31, 2004 (Q4 2004)	April 30, 2004 (Q3 2004)	January 31, 2004 (Q2 2004)	October 31, 2003 (Q1 2004)
Revenues	\$ 22,205	\$ 26,628	\$ 28,519	\$ 25,373	\$ 32,988	\$ 39,193	\$ 45,524	\$ 39,198
R&D expense ¹	7,461	9,900	10,709	6,142	8,477	7,429	5,743	3,962
Net income (loss)	(17,383)	1,890	(2,291)	2,321	7,753	6,247	8,707	9,835
Earnings (loss) per share								
Basic	\$ (0.27)	\$ 0.03	\$ (0.04)	\$ 0.04	\$ 0.12	\$ 0.10	\$ 0.14	\$ 0.16
Diluted	\$ (0.27)	\$ 0.03	\$ (0.04)	\$ 0.04	\$ 0.12	\$ 0.10	\$ 0.13	\$ 0.15

¹ Includes R&D expenditures, net of investment tax credits, classified as either Cost of sales – R&D or Independent R&D.

Variations in quarterly revenues over the past eight quarters illustrate the impact of the VIG contract and the Chesapeake smallpox vaccine subcontract on total revenues over the end of 2003 and through the first half of 2005. VIG sales to the U.S. government began in the second quarter of 2003, with final deliveries of \$11.2 million completed in the third quarter of fiscal 2004.

As a subcontractor on a U.S. government contract, Chesapeake commenced filling smallpox vaccine at its viral fill/finish facility in the second quarter of 2003 and completed this contract during the second quarter of 2005. The fourth quarter of 2004, and the first and second quarters of 2005 reflect both the impact of reduced contract-manufacturing activity and the effect of the weakened U.S. dollar on foreign currency translation. Research and development expenditures continued trending upward throughout fiscal 2004 due to a greater number of revenue-generating contract research and development projects, and from internal research and development of biopharmaceutical products.

In the first quarter of 2005, research and development expenditures and related revenues for the anthrax and botulinum contracts decreased from the prior quarter, due to the timing of specific project activities and milestones. During the second quarter of 2005, research revenues and costs from these contracts rose as the projects entered more active phases. In the third and fourth quarters, research revenues and costs declined, due mainly to lower research activity on the anthrax and VIG contracts. In the third and fourth quarters of 2005, the Company ceased recognizing the tax benefit of net operating losses generated in its U.S. operations and during the fourth quarter, recorded an impairment loss in the Chesapeake subsidiary relating to the viral vaccine facility. Net income and earnings per share over the eight quarters directly reflect the impact of fluctuations in revenues and earnings from the contract R&D and manufacturing activities.

LIQUIDITY & CAPITAL RESOURCES

Operating activities

Cash at July 31, 2005 was \$4.0 million, unchanged from the end of the 2004 fiscal year. Cash used in operating activities of \$9.3 million during fiscal 2005 compares to cash generated from operating activities of \$39.1 million in the prior year. The use of cash in the current year reflects \$8.1 million generated from operations, offset by an increase of \$24.1 million in working capital balances, compared to \$31.6 million generated from operations coupled with a \$5.6 million decrease in working capital balances in the prior year.

Net non-cash working capital, excluding bank debt, increased to \$46.3 million at July 31, 2005 from \$20.1 million at July 31, 2004. Higher working capital levels in 2005 resulted from increases in accounts receivable and inventory, partly offset by an increase in trade accounts payable, compared to July 31, 2004. The increase in accounts receivable is due to billing certain research contracts late in the quarter and higher balances due from international customers, while the increase in inventory is due to work-in-process inventories of VIG plasma and finished WinRho® SDF product, which the

Company anticipates will be used to meet future U.S. and international orders. Final tax payments for the 2004 fiscal year and tax instalment payments for the first quarter of 2005 reduced accrued taxes payable and increased the use of cash in the period.

Financing activities

Cash provided by financing activities totalled \$22.7 million in fiscal 2005 compared to cash used in financing activities of \$17.0 million in the same period of the prior year. The use of cash to repay \$25.7 million of long-term debt and finance \$24.4 million of capital expenditures in fiscal 2004 was largely generated from operations, with the remainder of \$8.7 million coming from proceeds of stock options exercised during the year. For the year ended July 31, 2005, although the Company repaid \$3.8 million of long-term debt and received proceeds of \$4.3 million on the exercise of stock options, it borrowed \$16.2 million on its operating facility and drew \$6.0 million on the facility-expansion term loan to fund \$13.4 million of capital expenditures and meet short-term cash requirements.

Equity

The Corporation's authorized share capital consists of an unlimited number of non-voting preferred shares with a 4% non-cumulative dividend entitlement; Class A preferred shares, to be issued in series with rights to be determined at issuance by the Board of Directors; and common shares. No preferred shares have been issued. The following table provides a continuity of the common shares issued and outstanding:

<i>in thousands of Canadian dollars except share-related data</i>	<i>Number of shares</i>	
Share capital as at July 31, 2003	60,707,570	\$ 16,063
Stock options exercised	625,650	2,505
Warrants exercised	2,650,000	6,148
Share capital as at July 31, 2004	63,983,220	24,716
Stock options exercised	1,037,750	4,321
Share capital as at July 31, 2005	65,020,970	\$ 29,037

The Corporation, through the Board of Directors, may authorize the grant of options to acquire up to 8 million common shares under terms of the stock option plan, provided that the number of options issued and outstanding to any one individual at any time does not exceed 5% of the outstanding common shares. At July 31, 2005, 1.1 million [July 31, 2004 – 0.8 million] options remained available to be granted under the existing plan. The exercise price of options granted under the plan cannot be lower than the market price of the Corporation's common shares on the date the options are granted. These options expire no later than five and eight years after the date they are granted for non-employee directors and employees, respectively, and vest over four fiscal years.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

A summary of the status of the Corporation's stock option plan as of July 31, 2005 and 2004 and changes during the years ending on those dates is presented below:

Stock Options	2005		2004	
	Number of shares	Weighted-average exercise price	Number of shares	Weighted-average exercise price
Outstanding at beginning of year	4,436,150	\$ 6.04	5,085,000	\$ 6.23
Granted	7,500	9.33	50,000	11.11
Exercised	(1,037,750)	4.16	(625,650)	4.15
Cancelled	(297,050)	9.67	(73,200)	9.72
Outstanding at end of year	3,108,850	\$ 7.02	4,436,150	\$ 6.52
Exercisable at end of year	3,098,225	\$ 7.01	3,928,563	\$ 6.04

The following table illustrates the expected and maximum number of common shares outstanding as at October 12, 2005, assuming exercise of all exercisable outstanding stock options:

	Exercise price	Number of securities outstanding	Weighted-average remaining contractual life	Number of securities outstanding and exercisable	Number of common shares upon conversion or exercise ¹
Common shares		65,020,970			65,020,970
Stock options	\$ 3.55	353,625	0.6 years	353,625	353,625
	3.50	309,000	1.2	309,000	309,000
	4.65	286,375	2.2	286,375	286,375
	8.03	404,300	2.9	404,300	404,300
	6.25	657,100	3.2	657,100	657,100
	7.04	56,300	3.8	56,300	56,300
	9.31	489,950	4.3	489,950	489,950
	10.60	534,700	5.0	534,700	534,700
	9.33	10,000	7.0	5,000	5,000
	\$ 9.33	7,500	7.0 years	1,875	1,875
Subtotal – Stock options		3,108,850		3,098,225	3,098,225
Total		68,129,820			68,119,195

¹ Assuming exercise of all exercisable options whether currently in the money or not. Closing price for Cangene's common shares on the Toronto Stock Exchange on October 12, 2005 was \$8.18.

During the year ended July 31, 2005, the Company recorded total stock-based compensation of \$0.7 million related to stock options granted after July 1, 2002 in accordance with the change in accounting policy detailed under the subheading Stock-based compensation in the Notes to the consolidated financial statements.

The table below presents pro forma net income and earnings per share for fiscal 2004 as if compensation expense related to stock options granted to employees had been determined based on the fair-value method. The table includes only stock options granted by the Corporation after August 1, 2002, the date of adoption of Section 3870, of the *CICA handbook*.

<i>in thousands of Canadian dollars except per-share data</i>	2004
Net income for the year as reported	\$ 32,542
Pro forma compensation expense	921
Pro forma net income for the year	\$ 31,621
Pro forma basic earnings per share	\$ 0.50
Pro forma diluted earnings per share	\$ 0.49

The estimated fair values of stock options issued during the years ended July 31, 2005 and 2004 were determined using the Black-Scholes options pricing model using the following weighted average assumptions: annualized volatility of 45%, risk-free interest rate of 4%, expected life of 5 years and a dividend yield of 0%. The resulting weighted-average fair value per option issued during the year ended July 31, 2005 was \$4.95 [2004 – \$4.95].

The Corporation anticipates that present and former employees and directors will continue to exercise options in the future as such options vest, to the extent that exercise prices are less than the market price of the common shares. The Corporation is currently considering alternatives to the existing stock option plan, and depending upon the outcome of such deliberations, may not grant any additional options under the existing plan.

The Corporation anticipates that it could raise new equity where new capital is required to fund growth, and where and when a market opportunity exists.

Debt

Effective January 1, 2005, the Corporation renewed its senior credit facilities, consisting of a \$20-million revolving operating line of credit, a new \$30-million term-loan facility to fund plant expansion, and \$2.8 million U.S. of non-revolving term loans, representing the remaining outstanding balance of a loan originally used to fund capital expenditures in 2002.

Advances under the operating line of credit bear interest at variable rates, either at Canadian prime, U.S. base rate, or LIBOR plus 1.25%, at the Corporation's option. The revolving facility is collateralized by a general security agreement in respect of all assets and the agreement expires on December 31, 2005 unless otherwise renewed at the option of the bank. As at July 31, 2005, the Corporation had \$16.2 million in advances [July 31, 2004 – \$Nil] outstanding under the revolving operating facility.

As at July 31, 2005, \$1.3 million U.S. [\$1.6 million Cdn] of the term loan used to fund capital expenditures remained outstanding [July 31, 2004 – \$3.3 million U.S. or \$4.3 million Cdn]. The remaining term loan outstanding is collateralized by a general security agreement and bears interest at LIBOR plus 1.5%. The Corporation is continuing to repay the outstanding balance through monthly principal instalments of \$165,000 U.S. [\$203,000 Cdn], with final repayment of any outstanding principal amount due on April 30, 2007.

As at July 31, 2005, \$6.0 million of the new non-revolving term-loan facility used to fund plant expansion was outstanding [July 31, 2004 – \$Nil]. The non-revolving term loan is collateralized by a general security agreement and bears interest at Banker's Acceptance rates plus 1.5%. The Company may draw up to \$30.0 million of this loan facility to fund plant expansion on or before September 30, 2006, after which the loan becomes repayable in equal monthly instalments over a period of five years.

In 1996, the Corporation's U.S. subsidiary, Chesapeake, received funding from the Maryland Industrial Development Financing Authority in the form of a \$7.0-million U.S. Economic Development Revenue Bond for the construction of its main production facility. The bond, secured by the subsidiary's real property, matures on August 1, 2018 and bears interest at LIBOR, except for \$2.0 million U.S. [\$2.6 million Cdn] that has interest payable at a fixed rate of 6.99% to November 2005. Chesapeake is required to make quarterly principal repayments on the bond of \$150,000 U.S. [\$184,000 Cdn]. As at July 31, 2005 there was a balance of \$2.9 million U.S. or \$3.5 million Cdn [2004 – \$3.5 million U.S. or \$4.6 million Cdn] outstanding under the bond.

Chesapeake also has a \$1.0-million U.S. revolving line of credit with a regional U.S. bank, which is secured by the subsidiary's inventory and accounts receivable. The revolving line of credit bears interest at LIBOR plus 2.25% and the facility matures on December 31, 2005. As at July 31, 2005, there was no balance [2004 – \$0.4 million U.S. or \$0.5 million Cdn] outstanding under the revolving line of credit.

The Corporation has available a \$5.0-million revolving term loan from its majority shareholder, Apotex Holdings Inc. Interest on the loan is payable at the Canadian prime rate plus 1% and the facility matures in 2006. As at July 31, 2005, no balance [July 31, 2004 – \$Nil] was outstanding under this revolving-term facility.

The following table summarizes the Corporation's long-term debt and other contractual obligations:

in thousands of Canadian dollars	Payments due by period				
	Total at July 31, 2005	Less than 1 year	1–3 years	4–5 years	After 5 years
Long-term debt	\$ 11,107	\$ 2,343	\$ 7,530	\$ 552	\$ 682
Capital lease obligations	–	–	–	–	–
Operating leases	4,453	1,875	1,480	154	944
Purchase obligations ¹	–	–	–	–	–
Other long-term obligations ²	–	–	–	–	–
Total contractual obligations	\$ 15,560	\$ 4,218	\$ 9,010	\$ 706	\$ 1,626

¹ "Purchase obligation" means an agreement to purchase goods or services that is enforceable and legally binding on the Company and that specifies all significant terms including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.

² "Other long-term obligations" means other long-term liabilities reflected on the Company's balance sheet.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Investing activities

Cash used in investing activities decreased to \$13.4 million for fiscal 2005, compared with \$24.4 million in the same period last year. The decrease in investing activity reflects reduced capital expenditures on plant and equipment during the current year following significant capital expenditures on information systems and expansion of the biopharmaceutical manufacturing facility in fiscal 2004. The Corporation is, however, further expanding its facilities to address new business opportunities and has commenced a capital expansion project that will expand its plasma fractionation capacity to meet future demand for hyperimmune production. At July 31, 2005, \$8.6 million [July 31, 2004 – \$Nil] has been spent on the fractionation expansion, and the Company has entered into agreements to spend a further \$3.5 million related to this project.

Summary

The Company's ability to generate funds from operating activities, including product sales, and contract R&D and manufacturing, as well as the ability to obtain debt financing from its bank and Apotex, are expected to provide sufficient liquidity to meet anticipated needs of existing projects, absent the occurrence of any unforeseen events.

RELATED-PARTY TRANSACTIONS

The Corporation has an agreement with Apotex to support the development of certain biopharmaceutical products. Research revenues received pursuant to this contract are based on the direct research costs plus a contribution to overhead. Under this agreement, Cangene will hold the licence to the products developed, and Apotex will be entitled to receive a 12% royalty on net sales and the right to distribute these products. Apotex and the Corporation will share profits equally after deducting royalty payments. No sales of biopharmaceutical products developed pursuant to this agreement have been made to July 31, 2005.

The Corporation also has agreements with Apotex to conduct contract research and contract manufacturing of two biopharmaceutical products for which Apotex intends to retain proprietary rights. The terms for these agreements are representative of normal commercial terms for the type of contract research being undertaken. The Corporation has no future rights or obligations beyond the current agreements with respect to these products.

On November 5, 1996, Cangene acquired the rights to a drug called Ferriprox™ (deferiprone) from Apotex in exchange for warrants to purchase 5.3 million common shares of the Corporation. A total of 2.65 million warrants subsequently expired during the year ended July 31, 2002 and the remaining

2.65 million warrants were exercised by Apotex on October 30, 2003. The Corporation receives 50% of any net profits from the sales of Ferriprox™ worldwide.

Pursuant to the above agreements, in the year ended July 31, 2005, Cangene earned revenues from Apotex of \$12.8 million [2004 – \$9.3 million] for developing biopharmaceutical products, \$5.9 million [2004 – \$7.6 million] from Ferriprox™ sales, and \$6.7 million [2004 – \$4.7 million] for other contract R&D activities.

As at July 31, 2005, accounts receivable included \$3.8 million [July 31, 2004 – \$4.6 million] from these related-party transactions. Related-party transactions are recorded at the exchange amount, which the Company believes to be the fair market value.

Cangene has entered into a rental agreement with Apotex for the use of certain facilities and equipment in order to conduct certain research activities. Under the terms of this agreement, the Corporation paid rent of \$0.4 million during fiscal 2005 [2004 – \$0.5 million].

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements that present fairly the financial position, financial condition and results of operations in accordance with Canadian generally accepted accounting principles requires that the Corporation make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the balance sheet date, and reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates. The following is a summary of critical accounting estimates and assumptions that the Corporation believes could materially impact its reported financial position, financial condition or results of operations.

Goodwill valuation and impairment

The Corporation acquired Chesapeake Biological Laboratories, Inc., a U.S.-based contract-manufacturing business, on January 31, 2001 and recorded goodwill at the time of acquisition with a book value and a fair value of \$51.8 million. The Corporation, in accordance with *CICA Handbook Section 3062 – Goodwill and Other Intangible Assets* ("Section 3062"), effective January 1, 2002, has established a process for testing the valuation of goodwill on an annual basis for purposes of determining any potential impairment. In order to establish that the carrying value of net assets, including goodwill, for a particular business reporting unit exceeds the fair value, the Corporation is required to make significant estimates and assumptions regarding the timing and magnitude of future cash flows.

When evaluating goodwill, the Corporation uses estimates or forecasts of future cash flows for the next five years, plus estimates of residual cash flows beyond that time, which are discounted using an estimated discount rate that reflects assumptions regarding its weighted-average cost of capital. Qualitative factors, including market presence and trends, strength of customer relationships, strength of local management, strength of debt and capital markets, and degree of variability in cash flows, as well as other factors, are considered in making assumptions with regard to future cash flows and the appropriate discount rate. The Corporation has not changed its approach or method of evaluating goodwill since it adopted this methodology; however, the Corporation believes that its contract-manufacturing operations in Canada and the U.S. are essentially identical and will work closely in tandem on certain future contract opportunities; consequently, the goodwill was evaluated in the context of an aggregated contract R&D and manufacturing segment.

Goodwill impairment reduces the carrying value of goodwill on the balance sheet and is recorded as a separate charge to income. Goodwill impairment would typically be a non-cash charge; since the valuation is performed on assets acquired and related cash outflows from prior investments. Subsequent to the adoption of Section 3062, and based on greater uncertainty in the marketplace, the Corporation recorded a loss of \$5.0 million with respect to its contract-manufacturing operations for the year ended July 31, 2002. No goodwill impairment was recorded in 2003 or 2004, and, based upon the recent evaluation, no goodwill impairment was recorded for the year ended July 31, 2005. A change in any of the significant assumptions or estimates used to evaluate goodwill could result in material change to the results of operations.

Impairment of long-lived assets

Subsequent to the acquisition of Chesapeake, the Corporation decided to make an additional investment in the U.S. contract-manufacturing subsidiary to construct a specialized fill/finish facility to process live viral vaccines. The decision to construct this facility was made in large part due to an award of a significant subcontract from a vaccine manufacturer that was a successful bidder on a major contract to supply smallpox vaccine to the U.S. government. The Corporation believed that sufficient future demand for live-virus contract fill/finish services existed to support the decision to invest.

During the second quarter of fiscal 2005, the existing subcontract to supply fill/finish services to the smallpox vaccine manufacture was concluded and the Corporation has subsequently been evaluating a number of opportunities to generate revenues and cash flow from this facility. In July 2005, Chesapeake entered into a non-binding letter of intent with a

different smallpox vaccine manufacturer to examine the feasibility and establish the necessary capital investment plans to prepare the facility for lease, on the basis that the vaccine manufacturer may be awarded all or part of a new major contract to supply smallpox vaccine to the U.S. government. Under the terms of the letter of intent, the parties will mutually examine the feasibility of using the facility and reach agreement on a capital investment plan within a period of 90 days. Prior to the expiry of the letter of intent, the viral manufacturer may decide to exercise its option to lease the facility or enter into a reservation agreement to reserve the facility for a limited period of time. There can be no assurance, however, that this party will enter into a lease or enter into any agreement to reserve the facility for any particular period of time.

The Corporation, in accordance with Section 3063 of the *CICA Handbook* and in light of the uncertainty regarding the future cash flows to be generated from this facility, evaluated this long-lived asset for potential impairment. The net book value of this asset was compared to the estimated future undiscounted and discounted cash flows to be generated directly from the use or operation of this facility over its expected remaining life. The Corporation was required to make significant estimates and assumptions regarding both the amount and timing of future estimated cash flows. The Corporation has concluded, based on the same approach and methodology used in prior periods, but with recent estimates and assumptions, that an impairment loss of \$18.0 million is required with respect to the Chesapeake viral facility.

Impairment relating to long-lived assets reduces the carrying value of the asset recorded on the balance sheet and results in a separate charge to income. The impairment relating to the viral facility is a non-cash charge since the investment was made in prior accounting periods.

Future benefit of tax-loss carryforwards

In accordance with *CICA Handbook Section 3465 – Income Taxes*, the Corporation should only recognize the future benefit of tax-loss carryforwards where it is more likely than not that sufficient future taxable income can be generated in order to fully utilize such losses and deductions. The Corporation is required to make significant estimates and assumptions regarding future revenues and earnings, and its ability to implement certain tax planning strategies in order to assess the likelihood of utilizing such losses and deductions. These estimates and assumptions are subject to significant uncertainty, and if changed could materially affect the Corporation's assessment of the ability to fully realize the benefit of the future income tax assets. Future tax asset balances would be reduced, and additional income tax expense recorded in the applicable

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

accounting period in the event that circumstances change and the Corporation, based on revised estimates and assumptions, determined that it was no longer more likely than not that future tax assets would be fully realized.

As at July 31, 2004, the Corporation had recorded a future tax asset of \$10.0 million to recognize the future benefit of previously unrecorded tax-loss carryforwards and deductible temporary differences arising from its U.S. operations, principally the Chesapeake subsidiary. During the third and fourth quarters of fiscal 2005, the Company did not recognize the future tax benefit of additional tax losses originating from U.S. operations in the quarters and does not expect to record the future benefit of any additional tax losses that may originate in future quarters, unless circumstances change to suggest that additional future taxable income can be generated to utilize such losses. The Company believes that tax losses currently recorded will be utilized. As at July 31, 2005, and after revaluing the tax asset at current exchange rates, the recorded future tax asset totalled \$10.9 million. Unrecorded tax losses and temporary differences, including the impairment loss, total \$22.8 million with a potential future tax value of \$9.1 million. Existing accumulated operating losses can be carried forward to offset future taxable income for periods of 15–20 years.

ACCOUNTING CHANGES, INCLUDING INITIAL ADOPTION OF ACCOUNTING POLICIES

The preparation of financial statements that present fairly the financial position, financial condition and results of operations in accordance with Canadian generally accepted accounting principles ("GAAP") requires that the Corporation adopt, select, and apply the appropriate accounting policies and principles, particularly where alternatives exist, within GAAP. During the first quarter of 2005, the Corporation initially adopted the following new accounting recommendation:

Stock-based compensation

In November 2003, the Canadian Institute of Chartered Accountants amended *Section 3870 – Stock-Based Compensation and Other Stock-Based Payments* to require that all stock-based compensation be measured and expensed using a fair-value-based methodology. The Corporation adopted the new recommendations effective August 1, 2004 on a retroactive basis, without restatement of prior periods. The effect of this change is to record a charge to net income in the current year equal to the fair value of all stock options granted since August 1, 2002 that vested during the current year. In addition, a cumulative adjustment to reduce retained earnings and increase contributed surplus was recorded at the beginning of the year, equal to the fair value of all stock options granted since August 1, 2002 that had become vested up to and including July 31, 2004.

The Corporation did not adopt any new accounting policies, nor did it change any existing accounting policies, other than noted above during fiscal 2005.

Recent accounting pronouncements

The following new handbook sections will be effective for fiscal years beginning on or after October 1, 2006.

Cangene is currently evaluating the effect that adoption of these standards will have on results of operations and financial positions.

CICA 3855 – Financial Instruments – Recognition and Measurement:

This section prescribes when a financial instrument is to be recognized on the balance sheet and at what amount, either a fair-value or a cost-based measure. The section also provides standards for reporting gains and losses on financial instruments.

CICA 3865 – Hedges:

This is an optional application that provides alternative treatments to Section 3855 (discussed above) for entities that choose to designate qualifying transactions as hedges for accounting purposes. It builds on existing *Accounting Guideline AcG-13 – Hedging Relationships*, and *Section 1650 – Foreign Currency Translation*, by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

CICA 1530 – Comprehensive Income:

This section provides a new requirement that certain gains and losses are to be temporarily presented outside of Net earnings and recognized as 'Other Comprehensive Income'. Comprehensive income is the change in equity of an enterprise during a period from transactions and other events, and circumstances from non-owner sources. Other comprehensive income comprises revenues, expenses, gains and losses that are recognized in comprehensive income, but excluded from net earnings.

FINANCIAL INSTRUMENTS

The current assets and liabilities of the Corporation, which are subject to normal trade terms, are financial instruments for which the recorded carrying values approximate the fair value. The long-term debt obligations of the Corporation, for which no ready market exists, have been evaluated on the basis of discounted cash flows and it is believed that the fair value of these obligations is approximately equal to the current carrying value. The Corporation is, however, exposed to financial market risks, including foreign currency exchange rates and interest rates on long-term debt obligations. The Corporation currently uses derivative financial instruments to manage exposure to changes in foreign currency exchange rates.

Foreign currency risk

Cangene operates internationally, and a majority of its revenue and a significant amount of its expenditures are denominated in U.S. dollars. The Corporation has entered into forward-exchange contracts to sell U.S. dollars and purchase Canadian dollars at fixed rates of exchange as a means of mitigating its exposure to fluctuations in exchange rates. The Corporation has not applied hedge accounting to these derivative instruments. The forward-exchange contracts are marked to market at each reporting date, and both realized and unrealized gains and losses resulting from settlement of these contracts and changes in exchange rates are recorded in income in the current period. Assets or liabilities arising from the unrealized gains or losses on these contracts are recorded on the balance sheets as current amounts receivable or payable. The Corporation uses these derivative instruments as a risk-management tool and not for trading or speculative purposes.

Interest rate risk

The Corporation is exposed to interest rate risk on borrowings under its revolving operating line of credit, non-revolving term loans, and a non-revolving industrial development bond, each of which is subject to variable interest rates. A portion of the outstanding balance of the industrial development bond is subject to a fixed interest rate. Reductions in long-term debt balances during the 2004 fiscal year significantly reduced the exposure to fluctuations in interest rates. Based on the current levels of debt outstanding, a significant change in short-term interest rates would be necessary to materially impact the Corporation's results of operations.

RISKS AND UNCERTAINTIES

The Corporation is subject to certain risks and uncertainties inherent in the operation of the business. It attempts to mitigate these risks through a combination of sound management practices, insurance and systems of internal control. Some of the principal risks and uncertainties, although not all inclusive are:

Risks associated with new product development

One of the core competencies of the Corporation is research and development of new biopharmaceutical products. Many of the Corporation's products are still under development. Considerable costs are incurred at every stage of identifying, developing, manufacturing and marketing new products.

There can be no assurance during any given research stage that any viable new products will be developed for which a market demand exists. The costs of conducting basic research to identify potential new product opportunities can be significant. There can be no assurance during any development stage that any new products developed will receive regulatory approval.

If approved, some of these products will compete with established products of proven safety and efficacy, the manufacturers of which can be expected to employ intellectual property challenges against commercialization of these products by Cangene. There can be no assurance that the Corporation's products will be commercialized or, if commercialized, that medical centres, hospitals, physicians or patients will accept them in lieu of existing treatments. Accordingly, there can be no assurance that these products can be manufactured successfully and marketed profitably.

Impact of regulatory delays on generic-style strategy

The Corporation plans a generic-style approach to the licensing of certain biopharmaceutical products, by which it expects to receive regulatory approval to sell and distribute these products with reduced clinical studies and within shorter time frames than for first-to-market products. There can be no assurance that regulatory agencies in any markets will accept this approach for all or any of the products. If this generic-style strategy cannot be successfully employed to obtain simplified product approval from the regulatory agencies, the Corporation would have to follow a full clinical-trial program for its biopharmaceutical drugs, which could materially slow the commercialization and increase the cost of approval. Longer approval times, leading to a delay in time-to-market, could materially affect the competitiveness of a particular product in terms of market penetration and price.

Dependence on availability and quality of raw materials

Cangene's profitable manufacture of WinRho® SDF and other hyperimmune products is dependent on a supply of plasma and other specialty products. Plasma is collected from donors through both company-owned and third-party collection centres, and accordingly is subject to donor participation. Furthermore, the level of antibodies in the plasma of donors is variable and unless concentrations are sufficient, the cost of processing plasma to the end product may not be economically viable. Cangene believes that it has sufficient relationships with third-party plasma collection centres to ensure an adequate supply of plasma in the foreseeable future; however, there can be no assurances that shortages will not develop.

Compliance with regulatory requirements

Cangene's ability to manufacture and ship its products is subject to numerous regulatory requirements and conditions, which are complex and evolving. The supply of product, and hence revenue generation, could be interrupted should compliance become an issue. There can be no assurances that the Corporation will remain in compliance at all times, although it undertakes continuous and stringent quality assurance, quality control and regulatory review processes internally to minimize this risk.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Reliance on distribution relationships

A significant portion of Cangene's revenues from its principal product, WinRho® SDF, are derived from sales through exclusive distributors in the U.S. and international markets. During 2005, the Corporation changed its U.S. distributor so that a sole distributor has the right to distribute WinRho® SDF throughout the U.S. and Europe. As a result, Cangene is relying on the sales and marketing strength, and the distribution channels through which this distributor operates for a significant portion of its revenues. There can be no assurance that the Corporation will be able to retain this distribution relationship indefinitely and that it will be able to rely upon the sales, marketing and distribution efforts of this distributor to continue supporting sales of this product in these significant markets.

Potential liabilities associated with intellectual property claims

Cangene has adopted a strategy to license and manufacture certain biopharmaceutical products as generic or follow-on alternatives to existing products in the marketplace. Due to the nature of the products being developed and the complexity of the law governing intellectual property rights, the Corporation may face increasing exposure to intellectual property claims as it pursues this strategy. Defending intellectual property claims, whether or not such claims have merit, can result in the Corporation incurring significant legal costs. Inability to defend such claims could lead to loss of rights to manufacture and sell a product, even after significant costs have been incurred for development and licensing. There can be no assurances that the Corporation will not become subject to intellectual property claims, nor can there be any assurance that the Corporation would be able to successfully defend such claims.

Customer concentration and reliance on contracts

Cangene is party to contracts with Canadian and U.S. government agencies, a small number of other third parties, and Apotex, a related party. There can be no assurance that these customers will continue to purchase products or services from the Corporation at current levels or at all.

Fluctuations in demand resulting from certain events

The Corporation has entered into contracts and submitted proposals for development and manufacturing of products for use in biodefence programs. By their nature, these contracts call for Cangene to supply such products to a national stockpile, to be used in the event of an actual incident or attack. Accordingly, demand for these products should be expected to fluctuate significantly, both at the time of establishing initial stockpiles and in the event of their use. There is no way to predict the level of future demand for such products.

Expansion into foreign markets

Cangene has sold WinRho® SDF in some 40 countries throughout the world, and views international markets as having significant potential for market expansion of several of its products. Although the Corporation believes that the international political and regulatory environment has not presented a sustained barrier to its ability to ship product in the past, there can be no assurance that future political or regulatory events will not impede distribution of products to international markets in the future.

Competition

Cangene competes in a number of segments within the biopharmaceutical industry, some of which are subject to significant competition. Competition in the contract R&D and manufacturing segment in North America appears to be intensifying, with a small number of well-positioned organizations attempting to provide a complete suite of services. Cangene anticipates it will compete with a number of larger manufacturers for the production of certain biopharmaceutical products. In addition, the Corporation anticipates facing increasing competition as it attempts to further penetrate existing markets and expand its products into new markets. Given these industry characteristics, existing or new competitors may be significantly larger and have greater financial, research, manufacturing or marketing resources than Cangene. These competitors may compete with Cangene in providing both products and services in markets in which Cangene currently operates, as well as compete to enter new markets where Cangene desires to expand. Further, competitors may employ tactics, such as intellectual property challenges, to prevent or impede Cangene's progress in expanding its markets. There can be no assurances that the Corporation will be able to achieve or maintain its desired market share in any particular industry segment or market.

Foreign currency risk

As noted previously, the majority of Cangene's revenues are generated from non-Canadian customers and accordingly are typically transacted in foreign currencies, primarily U.S. dollars. Although the Corporation also incurs significant U.S. dollar-denominated expenses, there has historically been a net inflow of U.S. dollars. In addition, the Corporation's net earnings can be materially affected directly by exchange rate fluctuations as net earnings from U.S. operations are translated to Canadian dollars for reporting purposes. The Corporation has entered into forward-exchange contracts in efforts to mitigate the impact of fluctuations in exchange rates on U.S. dollar cash flows.

ADDITIONAL INFORMATION

Additional information relating to Cangene Corporation, including the most recently filed Annual Information Form, can be found on the Company's website at www.cangene.com or on SEDAR at www.sedar.com.

The accompanying consolidated financial statements of Cangene Corporation are the responsibility of management and have been approved by the Board of Directors. The financial statements necessarily include some amounts that are based on management's best estimates, which have been made using careful judgment. Management has prepared the financial statements in accordance with Canadian generally accepted accounting principles. Financing and operating data elsewhere in the annual report are consistent with the information contained in the financial statements.

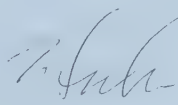
In fulfilling its responsibilities, management of Cangene Corporation maintains internal accounting controls. While no system will prevent or detect all errors or irregularities, the controls are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, transactions are properly recorded, and the financial records are reliable for preparing the financial statements.

The Board of Directors carries out its responsibility with respect to the consolidated financial statements primarily through its Audit Committee. The Audit Committee meets periodically with management and the external auditors to discuss the annual audit, accounting policies and practices, and other financial reporting matters.

The most recent financial statements have been audited by Ernst & Young, Chartered Accountants, who have full access to the Audit Committee, with and without the presence of management. Their report follows hereafter.



John Langstaff,
President and
Chief Executive Officer



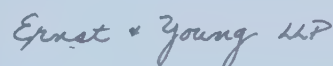
Michael Graham,
Chief Financial Officer

To the Shareholders of Cangene Corporation

We have audited the consolidated balance sheets of Cangene Corporation as at July 31, 2005 and 2004 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at July 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Winnipeg, Canada,
September 23, 2005

CONSOLIDATED BALANCE SHEETS

Incorporated under the laws of Ontario


As at July 31

in thousands of Canadian dollars

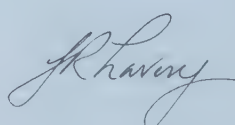
	2005	2004
ASSETS [notes 7 and 8]		
Current		
Cash	\$ 3,985	\$ 3,999
Accounts receivable [notes 14 and 15]	23,710	14,476
Income and other taxes recoverable	6,131	—
Inventories [note 4]	33,864	27,359
Prepaid expenses and deposits	1,629	1,888
Total current assets	69,319	47,722
Property, plant and equipment, net [note 5]	88,721	102,766
Future income taxes [note 10]	10,870	10,024
Goodwill [note 6]	40,514	40,514
	\$ 209,424	\$ 201,026
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness [note 7[b]]	\$ 16,157	\$ —
Accounts payable and accrued liabilities	19,044	16,327
Income and other taxes payable	—	7,342
Current portion of long-term debt [note 8]	2,343	3,324
Total current liabilities	37,544	26,993
Long-term debt [note 8]	8,764	5,578
Deferred income [note 9]	8,840	4,216
Future income taxes [note 10]	4,586	4,107
Total liabilities	59,734	40,894
Commitments [notes 14 and 19]		
Shareholders' equity		
Share capital [note 11]	29,037	24,716
Contributed surplus [note 3[b]]	3,348	—
Cumulative translation adjustment [note 12]	(4,467)	(4,467)
Retained earnings	121,772	139,883
Total shareholders' equity	149,690	160,132
	\$ 209,424	\$ 201,026

See accompanying notes

On behalf of the Board:



John Langstaff
Director



J. Robert Lavery
Director

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

Years ended July 31

in thousands of Canadian dollars except per-share data

	2005	2004
Revenues		
Product sales and services	\$ 55,726	\$ 113,798
R&D services [note 14]	41,104	35,548
Royalties [note 15]	5,895	7,557
	102,725	156,903
Cost of sales		
Product sales and services	34,283	65,074
R&D services [notes 14 and 16]	27,191	18,572
	61,474	83,646
Gross profit	41,251	73,257
Expenses		
Independent R&D [notes 14 and 16]	7,021	7,039
Selling, general and administrative	16,429	9,689
Amortization	9,437	6,961
Interest		
Short-term	512	125
Long-term	400	691
Foreign exchange gain	(691)	(2,493)
Facility impairment loss [note 5]	18,000	—
	51,108	22,012
Income (loss) before income taxes	(9,857)	51,245
Income tax expense (recovery) [note 10]		
Current	6,678	24,032
Future	(1,072)	(5,329)
	5,606	18,703
Net income (loss) for the year	(15,463)	32,542
Retained earnings, beginning of year, as previously reported	139,883	107,341
Adjustment to reflect change in accounting for employee stock options [note 3[b]]	(2,648)	—
Retained earnings, beginning of year, as restated	137,235	107,341
Retained earnings, end of year	\$ 121,772	\$ 139,883
Earnings (loss) per share [notes 11[b] and 13]		
Basic	\$ (0.24)	\$ 0.52
Diluted	\$ (0.24)	\$ 0.50

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended July 31

in thousands of Canadian dollars

	2005	2004
OPERATING ACTIVITIES		
Net income (loss) for the year	\$ (15,463)	\$ 32,542
Add (deduct) items not involving cash		
Unrealized foreign exchange loss (gain)	705	(348)
Amortization	9,437	6,961
Amortization of deferred income	(2,080)	(3,709)
Stock-based compensation	700	—
Net investment tax credits [note 17[b]]	(2,130)	1,960
Future income taxes	(1,072)	(5,329)
Gain on forgiveness of debt	—	(500)
Facility impairment loss	18,000	—
	8,097	31,577
Advance payments recorded as deferred income	6,704	1,950
Net change in non-cash working capital balances related to operations [note 17[a]]	(24,106)	5,599
Cash provided by (used in) operating activities	(9,305)	39,126
INVESTING ACTIVITIES		
Purchase of property, plant and equipment, net	(13,392)	(24,883)
Contributions received in aid of property, plant and equipment purchases	—	530
Cash used in investing activities	(13,392)	(24,353)
FINANCING ACTIVITIES		
Increase in bank indebtedness, net	16,157	—
Issuance of long-term debt	6,000	—
Repayment of long-term debt	(3,795)	(25,700)
Proceeds on exercise of stock options and warrants	4,321	8,653
Cash provided by (used in) financing activities	22,683	(17,047)
Net decrease in cash during the year	(14)	(2,274)
Cash, beginning of year	3,999	6,273
Cash, end of year	\$ 3,985	\$ 3,999
Interest paid	\$ 1,078	\$ 805
Income taxes paid	\$ 9,833	\$ 9,455

See accompanying notes

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

July 31, 2005 and 2004

1. DESCRIPTION OF BUSINESS

Cangene Corporation is a Canadian biopharmaceutical company in the business of developing, manufacturing, and commercializing products and technologies for global markets. Revenues are generated by product sales, contract manufacturing, contract research and development, and royalties. Generally, the Corporation manages its business and evaluates performances based on two operating segments: biopharmaceutical operations, and contract R&D and manufacturing. Cangene has two different categories of products in development: hyperimmune products, which are concentrated specialty antibody preparations made from plasma; and recombinant biopharmaceuticals, which are therapeutic proteins made by introducing a particular gene into a host organism, which in turn produces the protein of interest. The Apotex Group ("Apotex") is Cangene's majority shareholder and holds 80% of Cangene's common stock. The Apotex Group includes Apotex Holdings Inc., Apotex Inc., Apotex Research Inc. and other subsidiaries, and is indirectly controlled by Bernard Sherman.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applied on a consistent basis. The significant accounting policies are summarized below:

Consolidation

These financial statements consolidate the accounts of Cangene Corporation ("the Corporation" or "the Company") and its wholly-owned subsidiaries, Cangene U.S. Incorporated, Chesapeake Biological Laboratories, Inc. ("Chesapeake"), Biotherapeutic Laboratories, Inc. and Mid-Florida Biologicals, Inc.

Use of estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could differ from the estimates.

Inventories

Inventories are valued at the lower of average cost and net realizable value for finished goods and work-in-process, and replacement cost for raw materials. Cost for work-in-process and finished goods inventories includes materials, direct labour and an allocation of overhead.

Property, plant and equipment

Property, plant and equipment are recorded at cost, net of investment tax credits and impairment. Design, construction and installation costs related to assets under construction, including all costs for preparing the facility for its intended use, are recorded as construction in progress and are not subject to amortization until the asset is placed into service. Management assesses the carrying value of all property, plant and equipment, using its best estimate of undiscounted future cash flows, whenever conditions arise that could indicate a possible impairment. Any impairment is recognized as a reduction in cost, and the asset written down to estimated fair value, when it is identified. Amortization is provided on a straight-line basis over the following periods based on the estimated useful lives of the assets:

Buildings	25–30 years
Equipment, furniture and fixtures	5–10 years
Computer systems	3–5 years
Leasehold improvements	Term of lease

Goodwill

Goodwill represents the difference between the purchase price, including acquisition costs, of businesses acquired and the fair value of the identifiable net assets acquired. Goodwill is not amortized, but rather is subject to at least annual impairment tests by comparing the fair value of the Corporation's reporting units to their respective carrying value. Any impairment in carrying value is recognized when it is identified.

Income taxes

Income taxes are provided for using the liability method. Under this method, differences between the financial reporting bases and the income tax bases of the Corporation's assets and liabilities are recorded using the substantively enacted tax rates anticipated to be in effect when the differences are expected to reverse.

Foreign currency translation

[a] Domestic and integrated foreign operations

Assets and liabilities in foreign currencies related to domestic and integrated foreign operations are translated into Canadian dollars using current exchange rates at the balance sheet dates for monetary assets and liabilities, historical exchange rates for non-monetary assets and liabilities, and the average monthly exchange rate for revenues and expenses, except for amortization, which is translated at the historical exchange

rate of the corresponding non-monetary assets. Exchange gains and losses arising on translation are included in income in the period incurred.

[b] Self-sustaining foreign operations

Until April 30, 2004, the assets and liabilities of Chesapeake were translated into Canadian dollars using the rate of exchange in effect at the balance sheet dates. Revenue and expense items (including amortization) were translated at the average monthly exchange rate. Exchange gains and losses arising from the translation were included in the cumulative translation adjustment account, a separate component of Shareholders' equity. As well, the exchange gains and losses arising from the translation of the U.S. non-revolving loans [note 8], which had been designated as a hedge of the net investment in Chesapeake, were also included in the cumulative translation adjustment account.

Effective May 1, 2004, Chesapeake has been treated as an integrated foreign operation for foreign currency translation purposes and accordingly the balance sheet and income statement amounts are translated into Canadian dollars using the same method as described in [a] above.

Revenue recognition

The Corporation recognizes revenue from product sales, net of trade discounts and allowances, upon shipment, when all significant contractual obligations have been satisfied and collection is reasonably assured.

The Corporation has distribution agreements to market and distribute the Corporation's WinRho® SDF product. The Corporation's share of the revenue from sales of WinRho® SDF by the distributors is recognized by the Corporation upon shipment by the distributors from their warehouses to the customer.

Revenue under contract-manufacturing agreements is for commercial manufacturing and development services. Revenue is recognized when goods are shipped or services are provided in accordance with the terms of the related agreements.

Revenue from research contracts is recognized when the related costs are incurred, except for revenue received in respect of equipment used for research, which is recorded as deferred income and amortized over the useful life of the related asset.

The Corporation has certain collaborative agreements with third parties that may include multiple deliverables. A delivered item should be accounted for as a separate unit of accounting when:

- a) the delivered item(s) has stand-alone value to the customer,
- b) there is objective and reliable evidence of fair value of the remaining undelivered item(s),
- c) delivery of the undelivered item(s) is probable and substantially controlled by the vendor.

Revenues associated with multiple-deliverable arrangements are attributed to the various deliverables based on their relative fair value. Where a deliverable does not qualify as a separate unit of accounting, revenue attributed to the delivered item(s) is combined with revenue attributed to undelivered items within the arrangement.

Payments received under collaborative arrangements may include non-refundable up-front fees, funding for services performed and milestone payments for specific achievements. Non-refundable up-front fees are deferred and amortized into income on a systematic basis over the appropriate elements within the agreements. Non-refundable milestone payments are recognized into income upon the achievement of the specified milestones when the Corporation has no further involvement or obligation to perform related to that specific element of the arrangement. Milestone payments received that require the ongoing involvement of the Corporation are recorded as deferred revenue and amortized over the period of ongoing involvement.

Royalty revenue is recorded when the amount of the royalty fee is determinable and collection is reasonably assured.

Research and development expenses

Research expenses are charged to income in the year they are incurred, net of related tax credits. Development costs are charged to operations in the period of the expenditure unless a development project meets the criteria under Canadian generally accepted accounting principles for deferral and amortization. At July 31, 2005 and 2004, no development costs have been deferred.

Government assistance

Government assistance in connection with research activities is recognized as an expense reduction in the year that the related expenditure is incurred. Government assistance in connection with capital expenditures is treated as a reduction of the cost of the applicable asset.

Federal and provincial investment tax credits are accounted for as a reduction of the cost of the related assets or expenditures in the year in which the credits are earned and when there is reasonable assurance of their recovery.

Earnings (loss) per share

The calculation of earnings per share is based on net income divided by the weighted-average number of common shares outstanding during the year. Diluted earnings per share reflects the assumed conversion of all dilutive securities using the treasury stock method. Under the treasury stock method, the weighted-average number of common shares outstanding is calculated assuming that the proceeds from the exercise of options and warrants are used to repurchase common shares at the average price during the year. For the current year, the calculation of loss per common share on a fully-diluted basis excludes all potential common shares because the effect of including these shares would be to reduce the loss per share.

Stock-based compensation plan

The Corporation has a stock option plan as described in note 11[b]. Under the fair-value-based method, compensation cost is measured at fair value at the date of grant using the Black-Scholes option pricing model with assumptions described in note 11[b]. Compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period. Any consideration paid by employees upon exercise of stock options is recorded as an increase to share capital.

Financial instruments

The Company's financial instruments as of July 31, 2005 consist of cash, accounts receivable, income and other taxes recoverable, bank indebtedness, accounts payable and accrued liabilities, and long-term debt.

Unless otherwise stated in these financial statements, the fair value of the Corporation's financial instruments approximates their carrying value.

Derivative financial instruments are utilized by the Corporation to manage its foreign currency exposures. The Corporation does not enter into derivative financial instruments for trading or speculative purposes. Foreign exchange contracts are not accounted for as hedges and are marked to market at the balance sheet date. The gains and losses are recognized in income during the period.

The Corporation used foreign currency denominated debt to hedge its investment in its self-sustaining foreign operation until April 30, 2004. Realized and unrealized gains and losses from this hedge to April 30, 2004 were not included in the income statement, but were shown in the cumulative

translation adjustment account. The Corporation formally documented and assessed the effectiveness of this hedge at inception and on an on-going basis to April 30, 2004.

The Corporation is not exposed to significant interest rate risk and therefore did not employ interest rate hedging during the current year, allowing outstanding bank debt to generally float at short-term market rates of interest.

The majority of the Corporation's sales are made to governments and large, well-established companies. The Corporation, in the normal course of business, monitors the financial condition of its customers and reviews the credit history of each new customer. An allowance for doubtful accounts is established to correspond to the specific credit risk of its customers, historical trends and economic circumstances.

3. CHANGE IN ACCOUNTING POLICIES

[a] Foreign currency translation

Prior to May 1, 2004, the Corporation translated the accounts of one of its subsidiaries using the current-rate method of accounting as it was considered to be a self-sustaining subsidiary. Under this method, asset and liability accounts were translated at the rate of exchange prevailing at the balance sheet date. Shareholders' equity accounts were translated at applicable historical rates. Revenue and expense items were translated at the average monthly rate of exchange. The foreign exchange gain or loss on translation was recorded as a cumulative translation adjustment, reported as a component of Shareholders' equity. As a result of significant progress in the integration of operations, the Corporation re-classified the investment as an integrated subsidiary and adopted the temporal method of accounting as of May 1, 2004.

[b] Stock-based compensation

Prior to August 1, 2004, the Corporation applied the intrinsic-value method of accounting prescribed by the Canadian Institute of Chartered Accountants ("CICA") for stock-based payments to employees that cannot be settled in cash. Under the intrinsic-value method, any consideration paid by employees on the exercise of stock options was credited to share capital and no compensation expense was recognized.

The CICA has amended *CICA Handbook Section 3870 – Stock-based Compensation and Other Stock-Based Payments* ("Section 3870") to require entities to account for stock options using the fair-value-based method, beginning with fiscal

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

years commencing after January 1, 2004. Under the fair-value-based method, compensation cost is measured at fair value at the date of grant and is expensed over the award's vesting period.

In accordance with one of the transitional options permitted under amended Section 3870, the Corporation retroactively applied the fair-value-based method to all employee stock options granted on or after July 1, 2002 without restatement of prior periods. The cumulative effect of the change in accounting policy of \$2.6 million has been recorded as a decrease in the opening balance of retained earnings and an increase in contributed surplus at August 1, 2004.

During the year ended July 31, 2005, the Corporation recognized total compensation expense of \$0.7 million related to stock options granted after July 1, 2002.

4. INVENTORIES

in thousands of Canadian dollars

	2005	2004
Raw materials	\$ 8,921	\$ 14,047
Work in process	12,161	6,546
Finished goods	12,782	6,766
	\$ 33,864	\$ 27,359

5. PROPERTY, PLANT AND EQUIPMENT

in thousands of Canadian dollars

	2005			2004		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Land	\$ 705	\$ —	\$ 705	\$ 748	\$ —	\$ 748
Buildings	67,805	12,169	55,636	83,390	9,036	74,354
Equipment						
Production	35,062	14,998	20,064	28,331	11,281	17,050
Other	15,150	8,556	6,594	12,047	7,654	4,393
Furniture and fixtures	2,774	1,704	1,070	2,136	1,081	1,055
Computer systems	9,317	5,194	4,123	8,513	4,018	4,495
Leasehold improvements	1,672	1,143	529	1,672	1,001	671
	\$ 132,485	\$ 43,764	\$ 88,721	\$ 136,837	\$ 34,071	\$ 102,766

Buildings and equipment in the amount of \$8.6 million [2004 – \$3.6 million] are currently under development and are not being amortized.

In light of uncertainty regarding the future cash flows to be generated from the Corporation's viral vaccine fill/finish facility at Chesapeake, an evaluation of this long-lived asset for potential impairment was undertaken. The net book value of this asset was compared to the estimated undiscounted and discounted cash flows to be generated from the use or operation of this facility over its expected remaining life. The Corporation was required to make significant estimates and assumptions regarding both the amount and timing of future estimated cash flows. The Corporation has concluded, based on the same approach and assumptions, that an impairment loss of \$18.0 million is required. This amount has been reported under the Contract R&D and manufacturing segment.

6. GOODWILL

Goodwill at July 31, 2005 amounted to \$40.5 million [2004 – \$40.5 million], net of accumulated amortization and writedowns of \$11.1 million [2004 – \$11.1 million].

At July 31, 2005 and 2004, the Corporation conducted an annual review of the carrying value of goodwill and determined that there was no impairment.

7. OPERATING LINES OF CREDIT

In addition to the non-revolving credit facility described in note 8, the Corporation has available the following facilities:

- [a]** A \$1.0-million U.S. revolving line of credit facility, none of which was utilized at July 31, 2005 [2004 – \$0.4 million U.S.], collateralized by a subsidiary's inventory and accounts receivable. Interest is payable at LIBOR plus 2.25%. The effective rate of interest for the year was 4.6% [2004 – 3.4%]. This credit facility expires on December 31, 2005.
- [b]** To a maximum of \$20.0 million [2004 – \$15.0 million], a revolving term loan from a Canadian chartered bank, of which \$16.2 million was utilized at July 31, 2005 [2004 – \$Nil], collateralized by a general security agreement in respect to all assets. Interest is payable at LIBOR plus 1.25%. The effective rate of interest during the year was 4.0% [2004 – 3.4%]. The agreement expires on December 31, 2005 and is extendable at the bank's option.
- [c]** Apotex provides the Corporation with a \$5.0-million revolving term loan. Interest is payable at the prime rate plus 1%. The agreement expires in 2006. The facility has not been utilized in the past six years.

8. LONG-TERM DEBT

in thousands of Canadian dollars

	2005	2004
Canadian non-revolving facility-expansion loan, available up to a maximum of \$30 million, bearing interest at Bankers Acceptance rates, repayable in monthly instalments of \$500,000 commencing October 31, 2006, collateralized by a general security agreement over all assets. The effective rate of interest during the year was 4.6% [2004 – Nil%].	\$ 6,000	\$ —
U.S. bond maturing August 1, 2018, bearing interest at LIBOR, except for \$2.6 million with interest payable at a fixed rate of 6.99% to November 2005, quarterly principal repayments of \$184,000, collateralized by a subsidiary's real property. The effective rate of interest during the year was 4.7% [2004 – 4.1%]	3,501	4,559
U.S. long-term non-revolving loan, bearing interest at LIBOR plus 1.5%, repayable in monthly instalments of \$203,000 collateralized by a general security agreement over all assets. The effective rate of interest during the year was 3.8% [2004 – 2.7%]	1,606	4,343
	11,107	8,902
Less current portion	2,343	3,324
	\$ 8,764	\$ 5,578

Future repayment of long-term debt in the next five years is as follows:

in thousands of Canadian dollars

2006	\$ 2,343
2007	5,737
2008	1,793
2009	276
2010	276
Thereafter	682

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

9. DEFERRED INCOME

Deferred income consists of advance payments received from customers under the terms of agreements that require the Corporation to provide future products or services, or invest in assets that have useful lives beyond the current period. Deferred income is being amortized to earnings over the terms of the agreements or the useful lives of the assets, as applicable.

During the year ended July 31, 2005, the Corporation received a payment of \$3.0 million U.S. from Baxter Healthcare Corporation as part of a new distribution agreement. This payment has been recognized as deferred income in the year and is being amortized to income over approximately ten years.

10. INCOME TAXES

The Corporation's income tax provision is determined as follows:

<i>in thousands of Canadian dollars</i>	2005	2004
Combined statutory federal and provincial tax rate at 37.0% [2004 – 37.4%]	\$ (3,647)	\$ 19,166
Adjusted for		
Unrecognized losses of U.S. subsidiaries	2,685	—
Impairment loss not recognized	6,437	—
Other	131	(463)
Income tax expense	\$ 5,606	\$ 18,703

The Corporation's future income tax asset at July 31, 2005 in the amount of \$10.9 million [2004 – \$10.0 million] reflects the recognition of the potential future benefit of \$27.2 million of losses in the U.S. operations. The Corporation has not recognized the potential benefit of additional losses and other temporary differences of \$22.8 million relating to U.S. operations, which, if utilized, would result in an additional tax recovery of \$9.1 million.

Non-capital losses and their expiry dates as well as other temporary differences in the U.S. operations are as follows:

<i>in thousands of Canadian dollars</i>		
Year of loss	Year of expiry	Amount of tax attributes
1999	2018	\$ 536
2000	2019	280
2000	2020	1,289
2001	2021	5,229
2002	2022	312
2004	2024	10,329
2005	2025	9,169
Total tax losses		27,144
Temporary differences		22,839
		\$ 49,983

The future income tax liability at July 31, 2005 in the amount of \$4.6 million [2004 – \$4.1 million] reflects the tax effect of the temporary differences between the net book value of assets and the related cost for tax purposes in the Canadian operations.

11. SHARE CAPITAL

[a] Authorized and issued

The Corporation's authorized share capital comprises an unlimited number of non-voting preferred shares with a 4% non-cumulative dividend entitlement; Class A preferred shares, issuable in series with rights to be determined at issuance by the Board of Directors; and common shares.

Issued share capital comprises common shares as follows:

<i>in thousands of Canadian dollars</i>	Number of shares	
July 31, 2003	60,707,570	\$ 16,063
Stock options and warrants exercised	3,275,650	8,653
July 31, 2004	63,983,220	24,716
Stock options exercised	1,037,750	4,321
July 31, 2005	65,020,970	\$ 29,037

[b] Stock options

The Board of Directors may authorize the issuance of up to 8 million common shares upon the exercise of options by employees and directors under a stock option plan, provided that the number of options outstanding to any one individual at any time does not exceed 5% of the outstanding shares. At July 31, 2005, 1.1 million [2004 – 0.8 million] options remain available to be granted under the existing plan. The exercise price of options granted under the plan cannot be lower than

the market price of the Corporation's common shares on the date that the options are granted. These options expire no later than five and eight years after the date they are granted for non-employee directors and employees, respectively, and vest over four fiscal years.

A summary of the status of the Corporation's stock option plan as of July 31, 2005 and 2004, and changes during the years ending on those dates is presented below:

Stock Options	2005		2004	
	Number of shares	Weighted-average exercise price	Number of shares	Weighted-average exercise price
Outstanding at beginning of year	4,436,150	\$ 6.04	5,085,000	\$ 6.23
Granted	7,500	9.33	50,000	11.11
Exercised	(1,037,750)	4.16	(625,650)	4.15
Cancelled	(297,050)	9.67	(73,200)	9.72
Outstanding at end of year	3,108,850	\$ 7.02	4,436,150	\$ 6.52
Exercisable at end of year	3,098,225	\$ 7.01	3,928,563	\$ 6.04

The following table summarizes information about share options outstanding at July 31, 2005:

Exercise price	Fiscal year of grant	Options outstanding		Weighted-average exercise price	Options exercisable	
		Number outstanding	Weighted-average remaining contractual life		Number outstanding	Weighted-average exercise price
\$ 3.55	1998	353,625	0.6 years	\$ 3.55	353,625	\$ 3.55
3.50	1999	309,000	1.2	3.50	309,000	3.50
4.65	2000	286,375	2.2	4.65	286,375	4.65
8.03	2000	404,300	2.9	8.03	404,300	8.03
6.25	2001	657,100	3.2	6.25	657,100	6.25
7.04	2001	56,300	3.8	7.04	56,300	7.04
9.31	2002	489,950	4.3	9.31	489,950	9.31
10.60	2003	534,700	5.0	10.60	534,700	10.60
9.33	2004	10,000	7.0	9.33	5,000	9.33
9.33	2005	7,500	7.0	9.33	1,875	9.33
\$3.55-10.60		3,108,850	3.1 years	\$ 7.02	3,098,225	\$ 7.01

During the year ended July 31, 2005, the Corporation recorded total stock-based compensation of \$0.7 million related to stock options granted after July 1, 2002 in accordance with the change in accounting policy described in note 3[b].

Compensation expense was not recorded for the year ended July 31, 2004. The table below presents pro forma net income and earnings per share as if compensation expense related to stock options granted to employees had been determined based on the fair-value-based method. The table includes only stock options granted by the Corporation after August 1, 2002, the date of adoption of Section 3870:

<i>in thousands of Canadian dollars except per-share data</i>		2004
Net income for the year as reported	\$	32,542
Pro forma compensation expense		921
Pro forma net income for the year	\$	31,621
Pro forma basic earnings per share	\$	0.50
Pro forma diluted earnings per share	\$	0.49

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The estimated fair values of stock options issued during the years ended July 31, 2005 and 2004 were determined using the Black-Scholes options pricing model using the following weighted average assumptions: annualized volatility of 45%, risk-free interest rate of 4%, expected life of 5 years and a dividend yield of 0%. The resulting weighted-average fair value per option issued during the year ended July 31, 2005 was \$4.95 [2004 – \$4.95].

[c] Employee share ownership plan

Under the terms of the Corporation's Employee Share Ownership Plan, each year employees can choose to have up to 5% of their annual gross earnings, to a maximum of \$10,000, withheld to purchase common shares of the Corporation on the open market. The Corporation will match 20% of all contributions made by employees, which vest immediately. The Corporation's contribution is recorded as compensation expense. Under the plan, employees acquired 28,424 shares in 2005 [2004 – 21,796].

[d] Warrants

On October 30, 2003, Apotex exercised 2.65 million warrants for the purchase of common shares with an exercise price of \$2.32 per common share [note 15]. No other warrants remain outstanding.

12. CUMULATIVE TRANSLATION ADJUSTMENT

The cumulative translation adjustment comprises unrealized translation adjustments that arose on the translation of assets and liabilities of the Corporation's self-sustaining foreign operation to Canadian dollars and on the translation of related foreign currency debt designated as a hedge of the net investment in Chesapeake to April 30, 2004. An unrealized currency translation loss of \$0.5 million was recorded during the year ended July 31, 2004.

13. EARNINGS (LOSS) PER SHARE

The following is a reconciliation between basic and diluted earnings per share:

<i>in thousands of Canadian dollars except share related data</i>		2005	2004
Net income (loss)	\$	(15,463)	\$ 32,542
Weighted-average number of common shares outstanding		# 64,563,797	# 63,016,496
Dilutive effect of stock options		—	1,870,502
Diluted weighted-average number of shares outstanding		# 64,563,797	# 64,886,998
Earnings (loss) per share:			
Basic	\$	(0.24)	\$ 0.52
Diluted	\$	(0.24)	\$ 0.50

For the current year, the calculation of loss per common share on a fully-diluted basis excluded all potential common shares because the effect of including these shares would be to reduce the loss per share. For the year ended July 31, 2004, 40,000 options were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive. When the exercise price of options exceeds the average market price of the Corporation's common shares for the year, options are excluded from the calculation.

14. RESEARCH AND DEVELOPMENT

Research revenues are earned under terms of agreements with Apotex and through research agreements with third parties, including government institutions.

The Corporation has an agreement whereby Apotex funds Cangene's development of certain biopharmaceutical products up to and including post-licensure research and development. In 2005, the Corporation recorded revenue of \$12.8 million [2004 – \$9.3 million] under the terms of this agreement, of which \$1.7 million [2004 – \$1.2 million] was included in accounts receivable at July 31, 2005. Research revenue received pursuant to this contract is based on the direct research costs plus a contribution to overhead. Under this agreement, Apotex will be entitled to receive a 12% royalty on net sales of certain biopharmaceutical products developed by the Corporation and a right to distribute the products. Apotex and the Corporation will share profits equally after deducting royalty payments. No sales of biopharmaceutical products developed pursuant to this agreement have been made to July 31, 2005.

The Corporation also has separate agreements with Apotex to conduct contract R&D and contract manufacturing of certain biopharmaceutical products. Cangene recorded contract-R&D revenues of \$6.7 million [2004 – \$4.7 million] under terms of these agreements, of which \$0.7 million [2004 – \$1.2 million] was included in accounts receivable at July 31, 2005.

R&D expenditures, net of applicable investment tax credits and government assistance, consist of:

- a) expenditures under R&D agreements funded by Apotex, where Cangene will hold the product licences and will pay Apotex certain royalties and profit sharing
- b) expenditures under R&D contracts with Apotex, where Apotex will hold the product licence and Cangene will provide contract R&D services and may ultimately provide contract manufacturing
- c) expenditures under third party contract-R&D agreements funded by the third party, where Cangene retains primary intellectual property rights (e.g. U.S. government R&D contracts for VIG, anthrax and botulinum toxin hyperimmunes)
- d) expenditures under third party contract-R&D agreements funded by the third party, where the third party holds the intellectual property rights
- e) expenditures on independent R&D funded entirely by Cangene and for which Cangene holds all intellectual property rights

The following table provides details of R&D revenues and expenditures:

<i>in thousands of Canadian dollars</i>	2005	2004
R&D revenues		
Apotex agreements –		
Cangene holds licence	\$ 12,766	\$ 9,304
Apotex agreements –		
Apotex holds licence	6,695	4,704
Third party contracts –		
Cangene holds licence	19,336	20,076
Third party contracts –		
third party holds licence	2,307	1,464
	\$ 41,104	\$ 35,548
R&D expenditures		
Apotex agreements –		
Cangene holds licence	\$ 8,812	\$ 7,294
Apotex agreements –		
Apotex holds licence	2,948	1,350
Third party contracts –		
Cangene holds licence	14,200	9,693
Third party contracts –		
third party holds licence	1,231	235
Total cost of sales – R&D	27,191	18,572
Cangene independent R&D	7,021	7,039
	\$ 34,212	\$ 25,611

15. FERRIPROX™ (DEFERIPRONE) AGREEMENT

On November 5, 1996, the Corporation acquired the rights to a drug called Ferriprox™ from Apotex, in exchange for warrants to purchase 5.3 million common shares of the Corporation of which 2.65 million expired during the year ended July 31, 2002. Apotex exercised the remaining 2.65 million warrants on October 30, 2003 [note 11[d]]. The Corporation receives 50% of any net profits from sales of the drug worldwide. During the year ended July 31, 2005, the Corporation earned royalty revenue of \$5.9 million [2004 – \$7.6 million], representing its share of the net profits from the worldwide sales of Ferriprox™, of which \$1.4 million [2004 – \$2.2 million] was included in accounts receivable at July 31, 2005.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

16. GOVERNMENT ASSISTANCE

Federal and provincial investment tax credits, relating to scientific research activities and amounting to \$8.8 million [2004 – \$6.8 million], were included in the determination of income as a reduction of research and development expenses. In addition, investment tax credits relating to capital expenditures amounting to \$1.5 million [2004 – \$1.9 million] were accounted for as a reduction of the cost of the applicable assets.

17. SUPPLEMENTARY INFORMATION FOR CONSOLIDATED STATEMENTS OF CASH FLOWS

[a] Net decrease (increase) in non-cash working capital balances related to operations:

<i>in thousands of Canadian dollars</i>	2005	2004
Accounts receivable	\$ (9,234)	\$ 11,107
Inventories	(6,505)	(8,730)
Income and other taxes receivable	(4,001)	—
Prepaid expenses and deposits	259	381
Income and other taxes payable	(7,342)	6,719
Accounts payable and accrued liabilities	2,717	(3,878)
	\$ (24,106)	\$ 5,599

[b] Net investment tax credits utilized (earned) associated with research activities:

<i>in thousands of Canadian dollars</i>	2005	2004
Investment tax credits recorded as a reduction of R&D	\$ (8,808)	\$ (6,778)
Income tax expense not requiring a current cash payment due to the utilization of investment tax credits	6,678	8,738
	\$ (2,130)	\$ 1,960

18. SEGMENT INFORMATION

The Corporation manages its business and evaluates performance based on two operating segments: biopharmaceutical operations, and contract R&D and manufacturing. The products and services provided by biopharmaceutical operations include in-house product sales and royalties as well as related-party research and development on follow-on products. Contract R&D and manufacturing provides products and services to related and unrelated parties. The accounting policies of the Corporation's operating segments are the same as those described in note 2. There are no significant inter-segment transactions. The following presents segment operating results for the years ended July 31, 2005 and July 31, 2004, and identifiable assets as at July 31, 2005 and July 31, 2004:

	2005			2004		
<i>in thousands of Canadian dollars</i>	Biopharma- ceutical operations	Contract R&D and manu- facturing	Total	Biopharma- ceutical operations	Contract R&D and manufacturing	Total
Revenues						
Product sales and services	\$ 34,993	\$ 20,733	\$ 55,726	\$ 48,827	\$ 64,971	\$ 113,798
R&D services	12,766	28,338	41,104	9,304	26,244	35,548
Royalties	5,895	—	5,895	7,557	—	7,557
	53,654	49,071	102,725	65,688	91,215	156,903
Cost of sales						
Product sales and services	11,457	22,826	34,283	12,050	53,024	65,074
R&D services	8,812	18,379	27,191	7,294	11,278	18,572
	20,269	41,205	61,474	19,344	64,302	83,646
Gross profit	33,385	7,866	41,251	46,344	26,913	73,257
Expenses						
Independent R&D	7,021	—	7,021	7,039	—	7,039
Selling, general and administrative	6,785	9,644	16,429	2,483	7,206	9,689
Amortization	4,268	5,169	9,437	2,572	4,389	6,961
Interest						
Short-term	474	38	512	97	28	125
Long-term	—	400	400	—	691	691
Foreign exchange loss (gain)	407	(1,098)	(691)	673	(3,166)	(2,493)
Facility impairment loss	—	18,000	18,000	—	—	—
	18,955	32,153	51,108	12,864	9,148	22,012
Income (loss) before income taxes	14,430	(24,287)	(9,857)	33,480	17,765	51,245
Income tax expense (recovery)						
Current	6,093	585	6,678	14,574	9,458	24,032
Future	452	(1,524)	(1,072)	—	(5,329)	(5,329)
	6,545	(939)	5,606	14,574	4,129	18,703
Net income (loss) for the year	\$ 7,885	\$ (23,348)	\$ (15,463)	\$ 18,906	\$ 13,636	\$ 32,542
Tangible assets	\$ 90,633	\$ 78,277	\$ 168,910	\$ 83,087	\$ 77,425	\$ 160,512
Goodwill	\$ 3,216	\$ 37,298	\$ 40,514	\$ 3,216	\$ 37,298	\$ 40,514
Additions to property, plant and equipment, and goodwill	\$ 6,900	\$ 6,492	\$ 13,392	\$ 12,122	\$ 12,761	\$ 24,883

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Geographic information about the Corporation's revenue is based on the product shipment destination or the location of the contracting organization. Assets are based on their physical location as at July 31, 2005 and July 31, 2004.

<i>in thousands of Canadian dollars</i>	2005		2004	
	Revenue	Property, plant and equipment, and goodwill	Revenue	Property, plant and equipment, and goodwill
Canada	\$ 38,471	\$ 66,549	\$ 29,641	\$ 59,934
United States	50,751	62,686	116,382	83,346
Eurasia	13,503	—	10,880	—
	\$ 102,725	\$ 129,235	\$ 156,903	\$ 143,280

Sales to two customers represent 63% [2004 – one customer, 51%] of the revenue of the biopharmaceutical operating segment.

Sales to two customers represent 53% [2004 – one customer, 68%] of the revenue of the contract R&D and manufacturing segment.

19. COMMITMENTS

[a] Operating leases

At July 31, 2005, the Corporation has commitments under operating leases requiring minimum annual payments as follows:

in thousands of Canadian dollars

2006	\$ 1,875
2007	997
2008	483
2009	91
2010	63
Thereafter	944
	\$ 4,453

[b] Royalties

Under an agreement expiring in 2006, the Corporation pays royalties to the New York Blood Center, Inc. based on 3% of sales of WinRho® SDF, vaccinia immune globulin, anthrax immune globulin, and botulinum toxin immune globulin. During the year, these royalties amounted to \$1.3 million [2004 – \$3.1 million].

[c] Forward foreign exchange contracts

The Corporation has entered into forward foreign exchange contracts to sell U.S. dollars totalling \$5.0 million [2004 – \$9.0 million] with maturity dates ranging from August 2005 to December 2005 at exchange rates ranging from 1.24 to 1.26. The unrealized gain on these contracts at July 31, 2005 is \$0.1 million [2004 – \$0.4 million].

[d] Capital expansion project

The Corporation has commenced a capital expansion project for the purpose of expanding its plasma fractionation capacity to meet future demand for hyperimmune production. At July 31, 2005, \$8.6 million has been capitalized to Property, plant and equipment, and the Corporation has entered into commitment agreements to spend a further \$3.5 million in capital spending related to this project.

20. RELATED-PARTY TRANSACTIONS

In addition to related-party transactions disclosed elsewhere in the financial statements, the Corporation paid rent of \$0.4 million to Apotex [2004 – \$0.5 million]. These transactions occurred in the normal course of operations and were recorded at their exchange amount.

21. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's presentation.

GLOSSARY

Antibody A protein made by white blood cells that reacts with a specific foreign protein (antigen) as part of the immune response; autoimmune disorders occur when the body inappropriately makes antibodies against its own tissues or cells

Antigen See antibody

Category A/Category B The U.S. has identified and categorized certain agents and infectious organisms that pose a risk to national security. Category A is the highest priority designation; Category B is second.

CBRN Chemical, biological, radiological or nuclear incidents

CDC The U.S. Centers for Disease Control and Prevention

CRTI CBRN Research and Technology Initiative

DHF Dengue hemorrhagic fever: arises in severe cases of dengue fever; a mosquito-borne disease in the tropics, and causes increased blood vessel permeability resulting in plasma loss, decreased levels of blood platelets and hemorrhagic tendencies. DHF can kill through circulatory failure and shock.

DHHS U.S. Department of Health and Human Services

Expression system The cells into which a gene has been inserted to manufacture a desired protein

FDA United States Food and Drug Administration: a regulatory body

Follow-on protein product
A protein that is intended to be a similar version or copy of an already approved or licensed protein pharmaceutical product

GAAP Generally accepted accounting principles

GM-CSF Granulocyte-macrophage colony-stimulating factor: a stimulator of particular white-blood-cell development

Good Manufacturing Practices
Set of international quality guidelines for manufacturing practices

Hemolytic disease of the newborn
A serious blood-type incompatibility between a pregnant woman and the fetus

Hodgkin's and non-Hodgkin's lymphoma Two types of lymphoma differentiated by certain cellular characteristics. Lymphoma is cancer of the lymphoid tissue.

Hyperimmune A highly purified preparation of specific antibodies made from specialty plasma

Immunoglobulin or immune globulin
Class of proteins that function as antibodies. Hyperimmunes are preparations of immune globulins.

Indication Symptom or circumstance that indicates the advisability or necessity of a particular medical treatment

ITP Immune thrombocytopenic purpura: an autoimmune disorder causing abnormal destruction of blood platelets, potentially leading to severe bleeding

Monoclonal antibodies Antibodies made from a single source or clone of cells that recognize only one kind of antigen

Mutual Recognition Procedure
The pan-European regulatory procedure to obtain licensure in all European Union countries based on licensure in one member country

NIAID U.S. National Institute of Allergy and Infectious Diseases

Plasma The fluid (non-cellular) portion of blood

Platelet Small disk-shaped body in the blood, critical for normal blood-clotting

R&D Research and development

Recombinant proteins Proteins made from recombinant DNA, often describes proteins made by introducing their genetic information into a selected host cell for commercial production

SARS Severe acute respiratory syndrome

Stem-cell transplantation Stem cells are capable of differentiating into any blood cells. Transplantation can be used to repopulate a patient's blood with blood cells following chemotherapy or radiation treatments.

VIG Vaccinia immune globulin

DIRECTORS AND OFFICERS

DIRECTORS

R. Craig Baxter^{1,3} – Director

Mr. Baxter graduated with a BComm from Concordia University and is a Certified Management Accountant. He has 25 years of business experience, 20 of which have been in the pharmaceutical industry. Mr. Baxter is currently President of Apotex International, Inc. and Executive Vice President of Apotex Inc.

Jack Kay² – Director

Mr. Kay has more than 40 years' experience in pharmaceutical management and sales, including 23 years with Apotex. He has academic training in business administration from the University of Manitoba and McGill University. Mr. Kay is President and COO of Apotex Inc., and serves on the boards of Barr Laboratories, Inc., a NYSE-listed company, and Helix BioPharma Corp., a Toronto and Frankfurt Stock Exchange-listed company. He is Past Chair of the Canadian Generic Pharmaceutical Association, Chair of the International Schizophrenia Foundation, and Chair of Humber River Regional Hospital in Toronto.

John Langstaff – President, CEO and Director

Dr. Langstaff graduated from the University of Manitoba with a PhD in Microbiology in 1981. He served as Vice President of Operations and Research at ABI Biotechnology and through its evolution to Rh Pharmaceuticals. Dr. Langstaff became President and CEO when Apotex acquired Rh, a role he continued when Rh amalgamated with Cangene in 1995.

J. Robert Lavery^{1,3} – Director

Mr. Lavery, a Chartered Accountant, is President of Shaunnara Corp., an investment management company he has owned for the past 28 years. Until his retirement on December 31, 2003, Mr. Lavery was also President and CEO of Winpak Ltd., a position he held since co-founding the company in 1977. He continues as a member of the board of directors of Winpak Ltd. and all its subsidiary companies, and is a director of ENSIS Growth Fund Inc., Jazz Golf Equipment Inc., Online Business Systems, and SleeveCo, Inc. Mr. Lavery is on the Advisory Council of Friesen Corporation, the Advisory Board of Brett-Young Seeds Ltd., and has served on the boards of a number of community healthcare organizations.

Bernard Sherman – Chairman

Dr. Sherman graduated with a PhD from M.I.T. in 1967 and founded Apotex in 1974. He is currently Chairman and CEO of Apotex Inc. Dr. Sherman serves on the Board of Governors for Mount Sinai Hospital and the Baycrest Centre for Geriatric Care in Toronto.

Michael Spino² – Director

Dr. Spino completed his Post-Doctoral Research Fellowship at the Toronto Western Hospital in 1974. He subsequently worked as a Professor in the Faculties of Pharmacy and Medicine at the University of Toronto, and as a Senior Scientist at the Research Institute, Hospital for Sick Children in Toronto. Dr. Spino joined Apotex Inc. in 1991 where he is now President, ApoPharma Inc. In addition, he serves on the Board of Governors of Tyndale University College and Seminary.

Jerry Treppel^{1,3} – Director

Mr. Treppel is General Partner and fund manager at Wheaten HealthCare Partners LP and Principal of Wheaten Capital Management LLC in the United States. He was Managing Director of Equity Research at Banc of America Securities, LLC from June 1999 until 2002. From 1995 until 1999 he was Managing Director of Equity Research at UBS Warburg. He is also on the board of Akorn, Inc., an American Stock Exchange-listed company.

John Vivash² – Director

Mr. Vivash is President and CEO of Tesseract Financial Inc., positions he's held since founding the financial services company in 1989. Prior to that he held various senior positions during his lengthy career in the investment community. He has also participated on committees for the Toronto, Montreal and Vancouver Stock Exchanges and the Ontario Securities Commission. He has lectured extensively and has accumulated 20 years' of board experience. He is also on the Boards of Directors of State Street Trust Company of Canada, Draxis Health Inc., Sierra Systems Group Inc. and The Institute for Intellectual Capital Research.

OFFICERS

William Bees – Vice President, Operations

Michael Graham – Chief Financial Officer

Wendy Johnson – Vice President, Research & Development

John McMillan – Vice President, Commercial Development and Corporate Secretary

Andrew Storey – Vice President, Quality Assurance/Clinical and Regulatory Affairs

1 Member of Audit Committee

2 Member of Governance and Nominating Committee

3 Member of Compensation Committee

CORPORATE INFORMATION

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Chesapeake Website
www.cblinc.com

Fiscal Year-End
July 31st

Trading Symbol
CNJ (Toronto Stock Exchange)

52-Week Trading Range
C\$7.20-\$11.45 (at July 31, 2005)

Average Daily Trading Volume
24,330 (fiscal 2005)

Share Registrar and Transfer Agent
Computershare Investor Services Inc.
100 University Avenue, 9th Floor
Toronto, Ontario M5J 2Y1

Shareholder Inquiries
For further information about Cangene
and its activities, please contact
Ms. Jean Compton, Manager of Investor
Relations at Cangene in Mississauga,
(905) 405-2900, or by e-mail at
jcompton@cangene.com

Annual Meeting of Shareholders

Wednesday, December 7, 2005 at 4:15 pm

The Toronto Stock Exchange Broadcast & Conference Centre

The Exchange Tower, 130 King Street West, Toronto, Ontario M5X 1J2

QUARTERLY STOCK MARKET INFORMATION

Years ended July 31	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2005	2004	2005	2004	2005	2004	2005	2004
High*	\$ 11.10	\$ 12.95	\$ 11.45	\$ 12.50	\$ 10.50	\$ 11.85	\$ 8.95	\$ 10.60
Low*	\$ 8.95	\$ 11.27	\$ 8.25	\$ 10.90	\$ 7.76	\$ 9.65	\$ 7.20	\$ 9.21
Close*	\$ 10.75	\$ 12.29	\$ 9.90	\$ 11.58	\$ 7.95	\$ 10.15	\$ 8.82	\$ 9.35
Volume	1,189,532	1,282,499	2,417,483	1,741,430	1,832,711	2,356,130	667,123	973,110

*Highs and lows based on board lot trades on the TSX; closing price based on last business day of the quarter

CANGENE

ENDURING COMMITMENT

Cangene Corporation

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